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

III MONETARY AND CREDIT POLICY OPERATIONS

III.1 The conduct of monetary policy during 2006-07 faced various challenges due to persistent inflationary pressures and continuing large capital inflows. The major policy challenge was to manage the transition to a higher growth path while containing inflationary pressures so that potential output and productivity were firmly entrenched to sustain growth. During the year, inflationary pressures emanating from rising capacity utilisation, sustained growth in monetary and credit aggregates and elevated asset prices were exacerbated by supply shocks emerging from primary articles. The Reserve Bank stressed the need to be watchful for early signs of overheating, even though there was no conclusive evidence of potential overheating in the Indian economy. Against this backdrop, the Reserve Bank continued to take pre-emptive measures during the year to contain inflation and inflationary expectations. Monetary measures were supported by prudential measures to contend with sustained high growth in bank credit, particularly in certain sectors. Legislative amendments to the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949, which took place during the year, would provide greater flexibility to the Reserve Bank in the conduct of monetary policy in future.

III.2 The Reserve Bank persevered with its policy objective of ensuring adequate flow of credit to the various productive sectors of the economy, particularly agriculture and small scale industries (SSI). These initiatives were aimed at facilitating a conducive environment for banks to provide adequate and timely finance to small borrowers at reasonable rates without procedural hassles so as to bring about maximum financial inclusion of the poorer sections of the society.

III.3 In this backdrop, this Chapter delineates the monetary and credit policy operations of the Reserve Bank during 2006-07. Inflationary pressures, large capital inflows and government cash balances posed a major challenge in the conduct of monetary policy and liquidity management. Both wholesale and consumer price inflation rose during 2006-07; the increase in consumer price inflation was, however, much higher than the wholesale price inflation, reflecting mainly the impact of higher food prices and the higher weight of such items in consumer price inflation measures. The enduring nature of capital flows complicated the conduct of monetary policy and liquidity management as higher interest rates to contain inflation could potentially attract greater capital flows, thus, reducing the efficacy of monetary tightening. Policy rates and the cash reserve ratio were raised while interest rates on non-resident deposits were reduced. Prudential measures in the form of tightening of provisioning requirements in respect of sectors witnessing relatively higher order of credit growth were also undertaken to maintain asset quality and financial stability.

III.4 Alongside monetary and prudential measures, efforts were also made to improve credit delivery and promote financial inclusion. The Reserve Bank continued to take steps to improve the credit delivery mechanism for small borrowers in order to bring the poorer sections of the society within the fold of formal channels of credit delivery. Guidelines relating to the priority sector lending were revised in order to enlarge its base. Banks were advised to scale up information technology (IT) initiatives for speedy promotion of financial inclusion. As a part of a pilot project on greater financial inclusion, 100 per cent financial inclusion was achieved in the Union Territory of Puducherry and in 24 districts in Haryana, Himachal Pradesh, Karnataka, Kerala and Punjab. Reflecting the impact of various policy initiatives, banks achieved the targets fixed under the special agricultural credit plans and under the scheme of doubling the agricultural credit in three years.

III.5 As a part of the ongoing changes in the institutional framework of monetary policy in India and with a view to strengthening the consultative process, the Reserve Bank had constituted a Technical Advisory Committee (TAC) on Monetary Policy in July 2005 with external experts in the areas of monetary economics, central banking, financial markets and public finance. In its quarterly meetings, the TAC reviewed macroeconomic and monetary developments, provided useful policy inputs, contributed to enriching the processes of policy setting and advised on the stance of monetary policy. After its tenure ended in January 2007, the Reserve Bank reconstituted the TAC with a view to benefiting from the advice of the external experts with tenure up to January 31, 2009. The membership of the TAC was also expanded. The reconstituted TAC has five external members and two members of the Central Board of the Reserve Bank. The Committee is headed by the Governor, with the Deputy Governor in charge of monetary policy as vice-chairman. Three other Deputy Governors are also members of the Committee. It would meet at least once in a quarter to review macroeconomic and monetary developments and advise on the stance of monetary policy. It may be noted that the role of TAC is advisory in nature and it provides guidance in the process of formulating monetary policy from time to time. As such, the responsibility, accountability and time paths for decision making remain with the Reserve Bank.

MONETARY POLICY OPERATIONS: 2006-07

Annual Policy Statement for 2006-07

III.6 The Annual Policy Statement for 2006-07 (April 18, 2006) noted that the stance of monetary policy during 2006-07 would depend on macroeconomic developments including the global scenario. In an environment fraught with pressures from aggregate demand embodied in rising bank credit, high asset prices and above-trend growth in monetary aggregates as well as global risks from larger macroeconomic imbalances and higher oil prices than before, containing inflation in the medium-term was going to test the conduct of stabilisation policies. In this context, the Statement stressed that while there were compelling reasons to maintain the momentum in growth of output, low and stable inflation would enable higher growth on a sustained basis in an environment of overall stability. Furthermore, in the absence of firm and timely responses by all concerned, the rate of high credit growth and increase in asset prices seemed to pose a downside risk to overall financial stability.

III.7 While domestic macroeconomic and financial conditions supported prospects of sustained growth momentum with stability in India, there were risks to both growth and stability from domestic as well as global factors, with the balance of risks tilted towards the global factors. The adverse consequences of further escalation of international crude prices and/or of disruptive unwinding of global imbalances were likely to be pervasive across economies, including India. In a situation of generalised tightening of monetary policy, India could not afford to stay out of step. It was necessary to keep in view the dominance of domestic factors as in the past but to assign more weight to global factors than before while formulating the policy stance.

III.8 Under the assumption of a normal monsoon, positive industrial outlook and sustained momentum in services sector growth, the real GDP growth, for policy purposes, was placed in a range of 7.5-8.0 per cent during 2006-07 barring domestic or external shocks. Taking into account the real, monetary and global factors having a bearing on domestic prices, it was noted that containing inflationary expectations would continue to pose a challenge to monetary management. The policy endeavour was to contain the year-on-year (y-o-y) inflation rate for 2006-07 in the range of 5.0-5.5 per cent. For the purpose of monetary policy formulation, the expansion in M_3 was projected at around 15.0 per cent for 2006-07, consistent with the projected GDP growth and inflation. However, in view of the overhang of above-trend growth in money supply in the preceding year, the Statement observed that, in normal circumstances, the policy preference would be for maintaining a lower order of money supply growth in 2006-07. The growth in aggregate deposits was projected at around Rs.3,30,000 crore in 2006-07. Non-food bank credit including investments in bonds/debentures/shares of public sector undertakings and private corporate sector and commercial paper (CP) was expected to increase by around 20 per cent, implying a calibrated deceleration from a growth of above 30 per cent ruling at end-March 2006.

III.9 While leaving the repo rate and the reverse repo rate unchanged in the Annual Policy Statement, the Reserve Bank took certain prudential measures in the context of continued strong credit growth and in order to maintain asset quality. These included increases in (a) risk weight on exposures to commercial real estate and banks' total exposure to venture capital funds to 150 per cent; and (b) general provisioning requirement from 0.40 per cent to 1.0 per cent on standard advances in specific sectors (personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans) (Box III.1).

III.10 There was widespread and simultaneous monetary policy tightening in several countries in early June 2006 against the backdrop of marked and heightened volatility in the international financial markets. Though not entirely unanticipated, the virtual

Box III.1
Counter-cyclical Prudential Measures and Monetary Policy

Economic activity generally oscillates between phases of expansion and contraction. The expansionary phase of the economy is generally accompanied by high growth in bank credit – often concentrated in several specific sectors – which, in turn, poses risks to loan quality of the banking system and financial stability as well as inflation through exacerbation of demand pressures in the economy. An imbalanced growth poses risk of overheating in certain sectors. Counter-cyclical monetary policy tries to achieve price stability to sustain the growth momentum through pre-emptive withdrawal of monetary accommodation by modulation of interest rates/cash reserve ratios. While monetary measures affect the growth of all sectors in the economy, prudential policies are useful for ensuring the soundness of the banking system, avoiding the risks associated with high credit growth and credit concentration and limiting the distress to the entire financial system. The prudential measures can include higher/differentiated capital requirements, tighter/differentiated loan classification, tighter eligibility criteria for loans, dynamic provisioning, tighter collateral rules, rules on credit concentration, tightening net open foreign exchange position limits and maturity mismatch regulations and guidelines. Prudential measures when applied in sector-specific manner can be useful in curbing sector-specific credit growth, which could otherwise have an adverse spillover effect through emergence of non-performing assets (NPAs) in the period ahead.

It has been argued in an orthodox perspective that prudential regulations, originally designed for financial stability, are not very effective in addressing asset price cycles due to the time lag in transmission and the relatively blunt impact with unintended secondary consequences. Moreover, the use of such tools for macroeconomic purposes is seen as conflicting with their original objective of financial stability. However, the more contemporary, pragmatic view advocates the use of prudential regulations to dampen excessive credit growth in pursuit of financial stability as the ‘first instance’ policy response, followed at a later stage, if required, by tightening monetary policy (White, 2004).

In order to cope with rapid credit growth, a number of countries have opted for different prudential measures depending on the country-specific needs. Hong Kong, Romania and Singapore tightened eligibility requirements for certain types of loans including limits on loan-to-value ratio (for instance, mortgages) and limited foreign denominated loans to those with foreign exchange income or adequate hedge. It helped these countries to avoid very high levels of mortgage leverage and risks in market behaviour or asset prices. Higher and/or differentiated capital requirements or risk weights based on loan type, maturity and currency composition of credit and incorporation of market and other risks in capital adequacy ratios helped Bulgaria, Bosnia, Croatia, Norway and Poland to reduce total lending capacity of banks and enhance resilience of banks’ capital base against adverse shocks to the system. The Bank of Spain used dynamic provisioning in response to lesser loan loss provisioning compared to potential credit losses, which helped in improving banks’ asset quality. To stabilise property prices, Korea has recently announced a number of prudential measures like curtailing bank lending to the property sector, reduction in loan-to-value ratio, restricting mortgage loan issuance to one contract per person in addition to other measures such as introduction of price ceilings on new houses and disclosure of construction cost of new homes.

In India, rising economic activity in the upturn of the economic cycle propelled non-food credit growth to an average of around 30 per cent per annum during 2004-07. While growth in bank credit has been largely broad-based, substantially high credit growth has been observed in certain sectors such as commercial real estate, housing loan and consumer credit (including credit card), associated with sharp escalation in asset prices. Since 2004, the Reserve Bank has repeatedly drawn the attention of banks towards increasing credit concentration in some specific sectors and the associated risks, through its various Policy Statements and Reviews. Despite the articulation of these concerns, credit growth remained high raising concerns about financial stability and the sustainability of future growth, prompting a policy response. Accordingly, the Reserve Bank started tightening prudential regulations from October 2004. These policy measures have been broad-based comprising enhancing of risk weights in specific sectors while increasing provisioning requirements for standard advances across the board (see Chapter V). The measures taken by the Reserve Bank have helped in containing growth in credit to sectors witnessing high growth and maintaining financial stability.

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global coverage, nature and timing of these developments posed a serious threat to the domestic economy which, till then, had been spared of turbulence in the debt and foreign exchange markets. These developments, viewed in the light of the then prevailing monetary and credit environment underscored the compulsions of swift action, as indicated in the Annual Policy Statement. Accordingly, on June 8, 2006, the LAF reverse repo and repo rates were increased by 25 basis points each to 5.75 per cent and 6.75 per cent, respectively.

First Quarter Review

III.11 In its First Quarter Review of the Annual Statement on Monetary Policy (July 25, 2006), the Reserve Bank observed that the domestic economy was exhibiting strong fundamentals and displaying considerable resilience. At the same time, the Review pointed out that disturbing signs of demand pressures, especially continuing high credit growth, could exert upward pressure on prices when associated with supply shocks such as from oil. These pressures had the potential for impacting stability and inflationary expectations. Although domestic developments continued to dominate the Indian economy, global factors tended to gain more attention than before. The global outlook for growth was positive but downside risks in regard to inflation and re-pricing of risks in financial markets needed to be recognised. Both domestic and global factors were viewed as delicately balanced in terms of growth *vis-à-vis* price stability with a tilt towards the possibility of identified downside risks materialising in the near-term being more likely than before. While reaffirming its forecast for GDP growth of 7.5-8.0 per cent as set out in the April 2006 Statement, the Reserve Bank observed that containing the y-o-y inflation rate for 2006-07 in the range of 5.0-5.5 per cent warranted appropriate priority in policy responses. On balance, a modest pre-emptive action in monetary policy was considered appropriate. Accordingly, the Reserve Bank increased the reverse repo rate and the repo rate further by 25 basis points each to 6.00 per cent and 7.00 per cent, respectively, with effect from July 25, 2006 (Table 3.1).

Table 3.1: Movement in Key Policy Rates and Reserve Requirements

(Per cent)

Effective since	Reverse Repo Rate	Repo Rate	Cash Reserve Ratio
1	2	3	4
March 31, 2004	4.50	6.00	4.50
September 18, 2004	4.50	6.00	4.75 (+0.25)
October 2, 2004	4.50	6.00	5.00 (+0.25)
October 27, 2004	4.75 (+0.25)	6.00	5.00
April 29, 2005	5.00 (+0.25)	6.00	5.00
October 26, 2005	5.25 (+0.25)	6.25 (+0.25)	5.00
January 24, 2006	5.50 (+0.25)	6.50 (+0.25)	5.00
June 9, 2006	5.75 (+0.25)	6.75 (+0.25)	5.00
July 25, 2006	6.00 (+0.25)	7.00 (+0.25)	5.00
October 31, 2006	6.00	7.25 (+0.25)	5.00
December 23, 2006	6.00	7.25	5.25 (+0.25)
January 6, 2007	6.00	7.25	5.50 (+0.25)
January 31, 2007	6.00	7.50 (+0.25)	5.50
February 17, 2007	6.00	7.50	5.75 (+0.25)
March 3, 2007	6.00	7.50	6.00 (+0.25)
March 31, 2007	6.00	7.75 (+0.25)	6.00
April 14, 2007	6.00	7.75	6.25 (+0.25)
April 28, 2007	6.00	7.75	6.50 (+0.25)
August 4, 2007	6.00	7.75	7.00 (+0.50)

Note: 1. With effect from October 29, 2004, the nomenclature of repo and reverse repo was changed in keeping with international usage. Now, reverse repo indicates absorption of liquidity and repo signifies injection of liquidity. Prior to October 29, 2004, repo indicated absorption of liquidity while reverse repo meant injection of liquidity. The nomenclature in this Report is based on the new usage of terms even for the period prior to October 29, 2004.

2. Figures in parentheses indicate change in policy rates.

Mid-term Review

III.12 In the Mid-Term Review of the Annual Policy Statement for 2006-07 (October 31, 2006), the Reserve Bank observed that there seemed to be some evidence of demand pressures firming up in the form of high growth in capital goods output, an upturn in investment in infrastructure and a quickening of the capital expenditure cycle. Demand pressures were also visible in the expansion of money supply and reserve money. The demand for bank credit was growing at above 30 per cent for the third year in succession. Against this background, it was critical to be watchful for early signs of overheating, even though, for a developing economy like India, the concept of overheating was less of a guide for monetary policy than in advanced economies on account of (a) the existence of large unemployment/underemployment of resources and the absence of a clear assessment of potential output; and (b) the difficulty in obtaining a clear judgement of potential output in an economy undergoing structural transformation (Box III.2). Nevertheless, the combination of high growth and consumer inflation coupled with escalating asset prices and tightening infrastructural bottlenecks underscored the need to reckon with dangers of overheating and the implications for the timing and direction of monetary policy setting. The Review emphasised that although there was no conclusive evidence of potential overheating in the Indian economy, the criticality of monitoring all available indications that could point to excess aggregate demand was perhaps more relevant and that it would be risky to ignore the prevalence and relevance of these factors. At the same time, as the Review added, credit penetration

Box III.2

Overheating and Monetary Policy

Movements in inflation depend upon demand-supply mismatches. In this context, the concept of overheating in the economy plays a critical role in the conduct of monetary policy. An overheating economy is one which is growing rapidly and its productive capacity cannot keep up with the resulting demand pressures. The emergence of inflationary pressures is usually seen as the first indication of overheating. In this context, policy makers keenly analyse the behaviour of the output gap, *i.e.*, the excess of current output over potential or full capacity output. If the monetary authority senses that there is unutilised capacity, the increase in demand generated by growth can be accommodated without inflationary pressures and, therefore, the need to act against overheating may not arise. On the other hand, if demand runs ahead of full capacity, there will be a case for tightening of monetary policy with a view to slowing down the economy and heading off overheating.

Although the concept of overheating is analytically straightforward, its implementation is beset with a number of problems. Globally, there is some evidence of a blurring of the relationship between output gaps and inflation. Moreover, the size and direction of an economy's potential output is becoming increasingly difficult to diagnose. In particular, globalisation has expanded the supply potential of various economies, especially emerging economies. In the recent period, it appears that the current positive supply shock has made the concept of potential output fuzzier than in the past. In view of the growing globalisation, there is some evidence that domestic inflation is now increasingly influenced by global demand-supply imbalances in addition to domestic demand-supply imbalances.

These concepts and issues are further complicated for a developing economy like India on account of the existence of large unemployment/underemployment of resources and the absence of a clear assessment of potential output. The concept of overheating is, therefore, less of a guide for monetary policy in countries such as India than in advanced economies. Furthermore, it is difficult to pass a clear judgement of potential output in an economy that is undergoing structural transformation. Notwithstanding these uncertainties, monetary policy decisions have to be made and policy authorities are required to make an assessment of potential growth associated with non-accelerating inflation. This requires disentangling structural and cyclical components underlying the growth process.

Monetary management has to also look at imbalances that could be transitional. The challenge before the central bank is to manage the transition to a higher growth path, in the presence of some structural rigidities, in such a way that actual inflation and inflation expectations are contained and do not become mutually reinforcing. If supply responses are less than elastic, they could show up as excess demand, causing inflationary pressures and raising inflation expectations. Against this backdrop, managing structural change while keeping inflation low without dampening the growth momentum would be the quintessential challenge to monetary policy in India in the period ahead.

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Mohan, Rakesh (2007): Current Challenges to Monetary Policy Making in India, *Reserve Bank of India Bulletin*, March.

Reserve Bank of India (2006), Mid-Term Review of the Annual Policy Statement for 2006-07.

in India remained low, even by emerging economy standards, and the growing financial intermediation was possibly being reflected in monetary and credit aggregates in a manner that standard approaches failed to capture. These factors complicated the assessment of the extent of excess demand pressures.

III.13 Taking into account the trends in the real economy, the forecast for GDP growth for 2006-07 was revised upwards to around 8.0 per cent from the range of 7.5-8.0 per cent projected in the Annual Policy Statement and the First Quarter Review. On the demand side, the Mid-term Review observed that there were some indications of pressures and possible spillover into inflation expectations. Accordingly, containing the y-o-y inflation rate for 2006-07 in the range of 5.0-5.5 per cent assumed priority in terms of watchful monitoring and appropriate policy responses. The repo rate was, therefore, increased by 25 basis points to 7.25 per cent; the reverse repo rate was left unchanged at 6.00 per cent.

III.14 In the period subsequent to the Mid-term Review, macroeconomic performance turned out to be somewhat better than anticipated on the back of strong growth in manufacturing and services. Taking into account, *inter alia*, high growth in monetary aggregates, sustained growth in credit offtake, trends in liquidity absorbed under the LAF/MSS, challenges emanating from capital flows on liquidity, acceleration in inflation, growth in real GDP, expectations of the private corporate sector of higher increase in prices of both inputs and outputs, reports of growing strains on domestic capacity utilisation, global developments in monetary management and the paramount need to contain inflationary expectations, the Reserve Bank announced (on December 8, 2006) an increase of 50 basis points in the cash reserve ratio (CRR) in two phases – 25 basis points each effective the fortnights beginning December 23, 2006 and January 6, 2007. The increase in the CRR was consistent with the stance of the Mid-term Review of October 2006 of containing inflation expectations and consolidating gains achieved in regard to stability in order to sustain the momentum of growth on an enduring basis.

Third Quarter Review

III.15 In the Third Quarter Review of the Annual Statement on Monetary Policy (January 31, 2007), the Reserve Bank observed that there were continuing signs of aggregate demand firming up as reflected in the pick-up in investment intentions, synchronous high growth of capital goods production and capital goods imports, the buoyancy of consumer demand, the demand for bank credit remaining high, the widening trade deficit, reports that expansion of capacity may be constrained in terms of pending import orders, increasing evidence of the infrastructural bottlenecks becoming tighter and more binding, some indications of wage cost pressures, and elevated asset prices. Growth in bank credit was viewed as excessive, warranting measures to moderate growth even after accounting for the relatively low level of credit penetration in the country and the ongoing structural transformation of the economy. The relevant signs of overheating, especially in terms of aggregate demand, had firmed up in the period subsequent to the Mid-term Review. It was stressed that the addition to productive capacity occurred with a lag and the first sign of a step up in investment could be reflected in an expansion of aggregate demand.

III.16 Furthermore, as the Review pointed out, the enduring strength of capital inflows posed a challenge to monetary and liquidity management. In the event of demand pressures building up, increases in interest rates might be advocated to sustain growth in a non-inflationary manner but such action, apart from associated costs for growth and potential risks to financial stability, increased the possibility of further capital inflows so long as a significant part of these flows was interest sensitive and explicit policies to moderate flows were not undertaken. These flows could potentially reduce the efficacy of monetary policy tightening by enhancing liquidity.

III.17 In view of stronger than anticipated growth in manufacturing and services, forecast of real GDP growth for 2006-07 was revised upwards to a range of 8.5-9.0 per cent from around 8.0 per cent projected in the Mid-term Review and 7.5-8.0 per cent in the Annual Policy Statement and the First Quarter Review. Against the backdrop of the prevailing conditions of growth, price and financial stability, the Third Quarter Review stressed that unequivocal relative emphasis on stability was warranted. A determined and co-ordinated effort by all to contain inflation without unduly impacting the growth momentum was viewed as not only an economic necessity but also a moral compulsion. It was emphasised that effective containment of inflation was best served by a combination of fiscal, external and supply management policies supplemented and complemented by ongoing monetary measures.

III.18 The Review observed that evolving conditions underscored the importance of persevering with further withdrawal of policy accommodation in a timely manner to ensure both price and financial stability. A judicious balancing of weights assigned to monetary policy objectives would accord priority to stability in order to support growth on a sustained basis. Accordingly, an appropriate response in terms of policy stance and monetary measures was warranted to bring inflation as close as possible to the stated range of 5.0 to 5.5 per cent at the earliest, while continuing to pursue the medium-term goal of a ceiling on inflation at 5.0 per cent. The repo rate was, therefore, increased by 25 basis points to 7.50 per cent; the reverse repo rate was kept unchanged at 6.0 per cent. In order to modulate capital flows in the form of non-resident deposits so as to ensure effective liquidity management, the interest rate ceilings on NR(E)RA and FCNR(B) deposits were reduced by 50 basis points and 25 basis points, respectively (Table 3.2).

III.19 The provisioning requirement in respect of standard assets in the case of a few categories and risk weights were also increased in the Third Quarter Review (see Chapter V). The Review also stressed that, over the remaining part of the year, management of liquidity would receive priority in the policy hierarchy. Consequent to the tightening of market liquidity, the impact of monetary policy was expected to be stronger than before. The stance of monetary policy has progressively shifted from an equal emphasis on price stability along with growth (October 2004/April 2005) to one of reinforcing price stability with immediate monetary measures and to take recourse to all possible measures promptly in response to evolving circumstances (Box III.3).

III.20 In the period following the Third Quarter Review, some notable developments prompted a swift reinforcement of the monetary policy stance. With the pace of growth accelerating further as reflected in the buoyancy in industrial output and non-food bank credit, concerns about the accentuation of excess demand pressures seemed to be considerably heightened, particularly with the tightening of the supply constraints. Headline inflation surged to a two-year peak by end-January 2007, with potential upside risks to inflation expectations and, therefore, warranted an immediate policy response. Concomitantly, the LAF, which had been in an injection mode persistently during January 7–February 7, 2007 shifted to absorption mode in the following week (February 8-13) with additional liquidity absorbed under the MSS. Reflecting the large reversal of liquidity, the call money rate which was ruling 25-85 basis points above the repo rate, eased below the middle of the LAF corridor, indicating easing of liquidity conditions. It was considered necessary on February 13, 2007 to increase the CRR in two stages of 25 basis points each effective from the fortnights beginning February 17 and March 3, 2007. The increase in the CRR was intended to drain excess liquidity, pre-empt the stoking of demand pressures and contain inflation expectations. It was also consistent with the stance set out in the Third Quarter Review of responding swiftly to developments impinging on inflation expectations and the growth momentum.

Table 3.2: Interest Rate Structure for Non-Resident Deposits

(Basis points)

Effective since	FCNR(B) Deposits (Ceiling Rate)	Effective since	NRE (Rupee) Deposits (Ceiling Rate for 1-3 year maturity)
1	2	3	4
April 19, 2001	LIBOR	July 17, 2003	LIBOR + 250
April 29, 2002	LIBOR - 25	September 15, 2003	LIBOR + 100
March 28, 2006	LIBOR	October 18, 2003	LIBOR + 25
January 31, 2007	LIBOR - 25	April 17, 2004	LIBOR
April 24, 2007	LIBOR - 75	November 1, 2004	LIBOR + 50
		November 17, 2005	LIBOR + 75
		April 18, 2006	LIBOR + 100
		January 31, 2007	LIBOR + 50
		April 24, 2007	LIBOR

Note : LIBOR/swap rates for the respective currency/maturities in case of FCNR(B) deposits and LIBOR/swap rates for US dollar of corresponding maturity in case of NRE deposits.

Box III.3
Stance of Monetary Policy in India

2005-06

Annual Policy Statement (April 2005)

- Provision of appropriate liquidity to meet credit growth and support investment and export demand in the economy while placing equal emphasis on price stability.
- Consistent with the above, to pursue an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the momentum of growth.
- To consider measures in a calibrated manner, in response to evolving circumstances with a view to stabilising inflationary expectations.

First Quarter Review (July 2005)

- The overall stance of monetary policy for the remaining part of the year 2005-06 will continue to be as set out in the annual policy Statement of April 2005, but the Reserve Bank would respond, promptly and effectively, to the evolving situation depending on the unfolding of the risks.

Mid-term Review (October 2005)

- Consistent with emphasis on price stability, provision of appropriate liquidity to meet genuine credit needs and support export and investment demand in the economy.
- Ensuring an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the growth momentum.
- To consider measures in a calibrated and prompt manner, in response to evolving circumstances with a view to stabilising inflationary expectations.

Third Quarter Review (January 2006)

- To maintain the emphasis on price stability with a view to anchoring inflationary expectations.
- To continue to support export and investment demand in the economy for maintaining the growth momentum by ensuring a conducive interest rate environment for macroeconomic, price and financial stability.
- To provide appropriate liquidity to meet genuine credit needs of the economy with due emphasis on quality.
- To consider responses as appropriate to evolving circumstances.

2006-07 and 2007-08

Annual Policy Statement (April 2006)

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations.
- To focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability.
- To respond swiftly to evolving global developments.

First Quarter Review (July 2006)

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum while emphasising price stability with a view to anchoring inflation expectations.
- To reinforce the focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic and, in particular, financial stability.
- To consider measures as appropriate to the evolving global and domestic circumstances impinging on inflation expectations and the growth momentum.

Mid-term Review (October 2006)

- To ensure a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum while reinforcing price stability with a view to anchoring inflation expectations.
- To maintain the emphasis on macroeconomic and, in particular, financial stability.
- To consider promptly all possible measures as appropriate to the evolving global and domestic situation.

Third Quarter Review for 2006-07 (January 2007)/ Annual Policy Statement for 2007-08 (April 2007)/First Quarter Review for 2007-08 (July 2007)

- To reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum.
- To re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and, in particular, financial stability while simultaneously pursuing greater credit penetration and financial inclusion.
- To respond swiftly with all possible measures as appropriate to the evolving global and domestic situation impinging on inflation expectations, [financial stability (in July 2007 Statement)] and the growth momentum.

III.21 While indications of the sustained momentum of growth continued to firm up, the wholesale price index (WPI) inflation ruled stubbornly around 6.5 per cent up to March 23, 2007 threatening to impact inflation expectations. In terms of consumer prices, inflation was even higher in the range of 7.6-9.8 per cent. Other indicators of demand pressures were also emitting warning signals – money supply at around 22.0 per cent; non-food credit growth at 29.5 per cent; capacity constraints; pending import orders; pricing power of corporates as exemplified in the cement and steel sectors; wage pressures in some sectors; and rising input costs. Alongside these developments, there were large swings in liquidity and associated heightened volatility in the financial markets inconsistent with the prevailing monetary policy stance of tightening aggregate demand conditions to contain inflationary pressures and stabilise expectations. There was also a large build-up of the cash balances of the Government with the Reserve Bank and the unwinding of these balances thereafter portended a large reversal of liquidity in April 2007 and a return to sizeable surplus conditions. Furthermore, the mobilisation of deposits and expansion of non-food credit that typically occurs in the last fortnight of March unwinds in April resulting in a return flow of liquidity. An additional source of autonomous liquidity injection into the system was from the increase in net foreign assets of the Reserve Bank and corresponding release of rupee liquidity into the system. In the context of this scenario, it was considered necessary to reinforce the measures already taken for maintaining price stability and anchoring inflation expectations in order to sustain the growth momentum. Accordingly, the Reserve Bank announced monetary measures on March 30, 2007 with the objective of draining out liquidity and improving the efficacy of interest rate signals in the period ahead. The fixed repo rate under the LAF was increased by 25 basis points to 7.75 per cent with immediate effect. The CRR was increased by 50 basis points in two stages of 25 basis points each, effective from the fortnights beginning April 14 and April 28, 2007. It was also indicated that the policy of withdrawal of semi-durable and durable elements of liquidity through the MSS would continue along with other arrangements relating to the operation of the LAF. The objective of the measures undertaken was to continue to demonstrate that inflation beyond the tolerance threshold of the Reserve Bank was unacceptable and that the resolve to ensure price stability was always backed by timely and appropriate policy responses.

Bank Rate

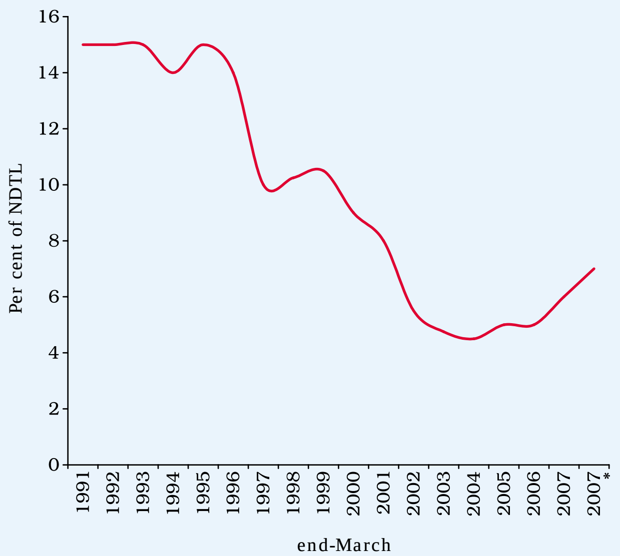
III.22 The Bank Rate signals the medium-term stance of monetary policy. Keeping in view the assessment of the economy including the outlook for inflation, the Bank Rate was retained at the existing level of 6.0 per cent; the rate was last revised in April 2003.

Cash Reserve Ratio

III.23 As noted earlier, the CRR was hiked by a cumulative of 100 basis points during 2006-07 in four equal phases of 25 basis points each during December 2006-February 2007. During 2007-08, the CRR has been raised further by another 100 basis so far (25 basis points each effective the fortnights beginning April 14 and April 28, 2007 and 50 basis points effective the fortnight beginning August 4, 2007) to 7.0 per cent of the banks' net demand and time liabilities (NDTL) (Chart III.1).

III.24 The Reserve Bank of India Act, 1934 was amended in June 2006 with a view to enhancing the Reserve Bank's operational flexibility and providing it with greater manoeuvrability in monetary management. The Reserve Bank of India (Amendment) Act, 2006 gives discretion to the Reserve Bank to decide the percentage of scheduled banks' demand and time liabilities to be maintained as CRR without any ceiling or floor. Consequent to the amendment, the Reserve Bank was also not required to make interest payment on CRR balances. The payment of interest on CRR balances attenuates

Chart III.1: Cash Reserve Ratio



* : August 4, 2007.

the effectiveness of the CRR as an instrument of monetary policy. Consequent to the amendment in June 2006, the Reserve Bank announced the removal of the floor of 3 per cent and ceiling of 20 per cent in respect of CRR. Furthermore, it was announced that no interest shall be payable on CRR balances with effect from the fortnight beginning June 24, 2006. The Extraordinary Gazette notification dated January 9, 2007 of the Government of India, however, notified January 9, 2007 as the date on which all the provisions, except Section 3, of the Reserve Bank of India (Amendment) Act, 2006 shall come into force. Section 3 of the Reserve Bank of India (Amendment) Act, 2006 provided for the removal of the ceiling and floor on the CRR to be prescribed by the Reserve Bank as also the provisions for interest payment on eligible CRR balances. Pending the notifications of the relevant provisions, the floor and ceiling on CRR were restored and the Reserve Bank decided to pay interest on eligible CRR balances but consistent with the monetary policy stance and measures at relevant periods of time. The Reserve Bank also exempted those banks from payment of penal interest which had breached the statutory minimum CRR level of 3.0 per cent during June 22, 2006 to March 2, 2007.

III.25 The Government of India in the Extraordinary Gazette notification dated March 9, 2007 notified Section 3 of the Reserve Bank of India (Amendment) Act, 2006 and appointed April 1, 2007 as the date on which the related provisions shall come into force. As such, the floor and ceiling on the CRR to be prescribed by the Reserve Bank now no longer exist. The Reserve Bank decided, in view of the then prevailing monetary conditions, to maintain *status quo* on the existing provisions of the CRR maintenance, including the CRR rate and extant exemptions. The Reserve Bank also indicated that no interest will be payable on CRR balances of banks with effect from the fortnight beginning March 31, 2007.

Statutory Liquidity Ratio

III.26 The statutory liquidity ratio (SLR) was kept unchanged at 25 per cent of banks' NDTL during 2006-07; the ratio was last revised in November 1997. Commercial banks' holdings of Government securities, as a proportion to their NDTL, continued to decline during the year, reaching 28.0 per cent of their NDTL at end-March 2007 from 31.3 per cent at end-March 2006 – closer to the prescribed requirement of 25 per cent. During 2007-08 so far (up to August 3, 2007), banks' holding of SLR securities as a percentage of NDTL increased marginally to 28.6 per cent.

III.27 Consequent upon the promulgation of the Banking Regulation (Amendment) Ordinance, 2007 dated January 23, 2007, Section 24 of the Banking Regulation Act, 1949 was amended, which, *inter alia*, removed the floor rate of 25 per cent for SLR to be prescribed by the Reserve Bank and empowered it to determine the SLR-eligible assets, thereby giving it more flexibility in its monetary management operations. The Ordinance was subsequently repealed and replaced by the Banking Regulation (Amendment) Act, 2007 which received the assent of the President on March 26, 2007 and is deemed to have come into force on January 23, 2007.

III.28 In order to strengthen the analytical framework for the conduct of monetary policy, the Reserve Bank has initiated a number of surveys in the recent period to capture timely information on the evolving economic conditions (Box III.4).

Liquidity Management

III.29 During 2006-07 the Reserve Bank continued with its policy of active management of liquidity through LAF, MSS and CRR, using all the policy instruments at its disposal flexibly. The aim was maintenance of appropriate liquidity in the system so that all legitimate requirements of credit, particularly for productive purposes, are met consistent with the objective of price and financial stability. Liquidity management assumed priority in the policy hierarchy in the quarter ended March 2007.

III.30 Liquidity conditions during 2006-07 continued to be influenced by sustained credit offtake, seasonal variations in currency demand, capital inflows and quarterly tax collections. Financial markets shifted from conditions of easy liquidity during the most part of the first half of the year to occasional spells of tightness in the second half, especially the last fortnight of March 2007. The task of liquidity management turned out to be more complex during 2006-07 on account of greater variations in cash balances of the Governments and capital flows (Tables 3.3 and 3.4).

III.31 During the first quarter of 2006-07, unwinding of the Centre's surplus balances with the Reserve Bank and the Reserve Bank's purchase of foreign exchange from authorised dealers led to ample liquidity into the banking system. This was reflected in an increase in the LAF reverse repo balances from Rs.7,250 crore at end-March 2006 to Rs.57,245 crore as on last Friday of May 2006 (Chart III.2). The balances under the LAF, however, fell in the subsequent months

Box III.4
Surveys as Analytical Inputs for Monetary Policy

Given the forward looking nature of monetary operations, the central banks' actions are critically dependent upon the evolving economic outlook. In this context, timely surveys can provide useful information on the likely course of economic activity in the near term. Like other major central banks, the Reserve Bank has initiated a number of surveys to capture such information.

A 'Survey of Inventories, Order Books and Capacity Utilisation', was launched recently by the Reserve Bank, for the manufacturing corporate sector to capture the most recent available information (yearly and quarterly) at the industry level on various important business cycle indicators, *viz.*, product-wise installed capacity (in terms of quantity), quantity and value of production, value of order books, export orders, backlog orders and value of inventories and various important short-term economic indicators, *i.e.*, inventory to sales ratio, capacity utilisation rate at various levels (overall, product-wise and industry-wise) and growth of order books.

The 'Quarterly Industrial Outlook Survey' provides insights into the performance and prospects of the private corporate sector engaged in manufacturing activities. This survey presents an advance assessment of the likely economic and industrial environment based on the qualitative data collected from the public limited manufacturing companies in the private sector.

Cross-country experience suggests that actual inflation movements are heavily influenced by inflation expectations. Major central banks make extensive use of inflation expectations surveys in the conduct of monetary policy. The Bank of England undertakes quarterly surveys of public opinion and awareness about inflation and interest rates. The results of these surveys constitute an important input for the Monetary Policy Committee (MPC). The US Federal Reserve analyses a number of survey measures of inflation expectations. According to Bernanke (2007), "measures of longer-term inflation expectations, such as the five-to-ten-year expected inflation measures from the Michigan/Reuters survey of households and from the Survey of Professional Forecasters, seem to be better gauges of the expectations that influence wage- and price-setting behaviour". The experience of the European Central Bank indicates that consumer expectations from the European Commission's survey provide important information on future inflation in the euro area. The experience of the Reserve Bank of New Zealand shows that while survey data may be inaccurate predictors of the level of inflation, they still provide useful directional information regarding near-term inflationary pressures, which can be used to supplement other economic indicators, giving a better indication of future inflation. Therefore, timely information, on the public expectations of inflation is important input for the conduct of monetary policy. Whether or not there is an explicit numerical objective, anchoring inflation expectations requires a central bank to keep inflation low and stable, to reinforce its commitment to price stability, and to clearly communicate its policies in pursuit of that commitment. 'Inflation Expectations Survey' being conducted by the Reserve Bank from September 2005 solicits inflation expectations from households through quarterly surveys. The scope of the questionnaire has been progressively fine-tuned to make it more useful for policy. The questionnaire initially elicited the respondents' views on directional movement in prices on four parameters (general price level, prices of food products, house rent and cost of services) for the next 3 months and for next one year. Two additional parameters (*i.e.*, prices of non-food products and prices of household durables) were included in Second round of the survey in addition to the above four parameters. An additional question, seeking quantitative measures on the expected rate of inflation for next 3 months and for next one year, was also included in the survey conducted in the month of December 2005. The views of respondents on current rate of inflation were also collected from the Fifth round (*i.e.*, quarter ended September 2006) onwards.

A Technical Advisory Committee for Surveys (TACS) under the Chairmanship of Dr. Rakesh Mohan, Deputy Governor, Reserve Bank of India has been constituted to review the methodology and results of the surveys.

Reference:

Mohan, Rakesh (2007), Statistical System of India: Some Reflections, *Reserve Bank of India Bulletin*, July.

Bernanke, Ben S. (2007): "Inflation Expectations and Inflation Forecasting", Remarks at the Monetary Economics Workshop of the National Bureau of Economic Research Summer Institute, Cambridge, Massachusetts, July 10.

(June-September 2006), partly reflecting switch towards the MSS as well as increase in the Centre's cash surplus. Balances under the MSS rose from Rs.24,276 crore at end-April 2006 to Rs.42,364 crore by end-August 2006, following the reintroduction of issuances under the MSS in May 2006. Beginning mid-September 2006, liquidity conditions became tighter on account of advance tax outflows and festive season currency demand. Liquidity pressures eased by end-October 2006, initially on account of decline in the Centre's surplus cash balances and subsequently, in November 2006, on the back of

Table 3.3: Liquidity Management

(Rupees crore)

Outstanding as on last Friday	LAF	MSS	Centre's Surplus with the RBI@	Total (2 to 4)
1	2	3	4	5
2006				
January	-20,555	37,280	39,080	55,805
February	-12,715	31,958	37,013	56,256
March*	7,250	29,062	48,828	85,140
April	47,805	24,276	5,611	77,692
May	57,245	27,817	-1,203	83,859
June	42,565	33,295	8,621	84,481
July	44,155	38,995	8,770	91,920
August	23,985	42,364	26,791	93,140
September	1,915	42,064	34,821	78,800
October	12,270	40,091	25,868	78,229
November	15,995	37,917	31,305	85,217
December	-31,685	37,314	65,582	71,211
2007				
January	-11,445	39,375	42,494	70,424
February	6,940	42,807	53,115	1,02,862
March*	-29,185	62,974	49,992	83,781
April	-9,996	75,924	-980	64,948
May	-4,690	87,319	-7,753	74,876
June	-8,895	81,137	-15,159	57,083
July	2,992	88,010	-20,199	70,803
August (as on Aug. 17)	30,650	1,00,960	27,771	1,59,381

@ : Excludes minimum cash balances with the Reserve Bank in case of surplus.

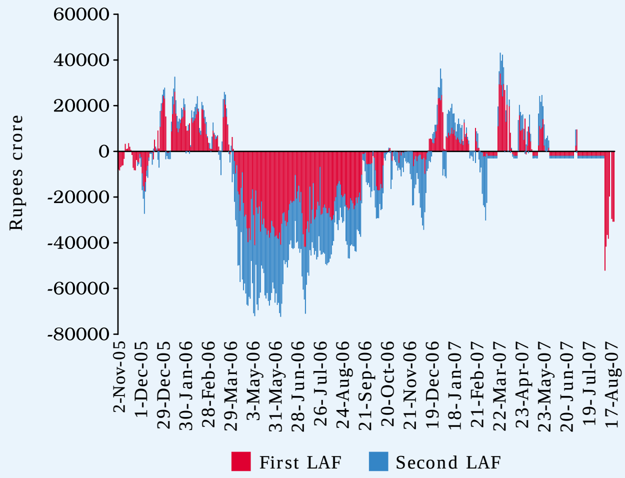
* : Data pertain to March 31.

Note: 1. Negative sign in column 2 indicates injection of liquidity through LAF repo.

2. Between March 5 and August 5, 2007, daily reverse repo absorptions were restricted to a maximum of Rs.3,000 crore comprising Rs.2,000 crore in the First LAF and Rs.1,000 crore in the Second LAF.

3. Negative sign in column 4 indicates WMA/overdraft.

Chart III.2: Repo (+)/ Reverse Repo (-) under LAF



Note : 1. Additional LAF on March 31, 2006 and March 31, 2007 are shown under the second LAF.

2. (+) indicates injection of funds into the banking system, while (-) indicates absorption of funds from the banking system.

market purchases of foreign exchange by the Reserve Bank (Table 3.5). This was mirrored in balances under the LAF reverse repos increasing from Rs.1,915 crore at end-September 2006 to Rs.15,995 crore by end-November 2006.

III.32 Liquidity conditions tightened from the second week of December 2006, mainly on account of increase in the Centre's cash balances and announcement of increase in the CRR by 50 basis points in two phases.

Table 3.4: Monthly Primary Liquidity Flows and Open Market Operations

(Rupees crore)

Month	RBI's Net Foreign Currency Assets #			Net Repos under the LAF			RBI's Initial Subscription@	Net Open Market Operations			Market Stabilisation Scheme		
	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08	2005-06	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Apr	1,432	20,832	11,935	-8,320	-40,555	-19,189	0	-263	-112	-313	-2,876	4,786	-12,951
May	1,970	4,781	8,138	-5,470	-9,440	-5,306	0	-325	-1,303	-680	-1,929	-3,541	-11,395
Jun	1,632	2,494	27,655	23,450	26,935	-7,687	0	-954	-121	-252	-2,665	-5,307	4,702
Jul	1,378	2,556	25,219	-815	-15,760	-3	0	-526	-968	-664	-47	-4,603	-2,410
Aug	20,069	2,993		-15,450	16,080		0	-66	5		1,765	-2,205	
Sep	2,218	5,399		1,430	28,075		0	-348	-214		2,635	-2,133	
Oct	2,254	4,031		3,665	-10,355		0	-124	-233		-2,424	1,973	
Nov	2,811	17,066		17,155	-3,725		0	-79	-131		5,420	2,174	
Dec	6,933	10,536		-2,185	36,275		0	-59	-24		16,717	-832	
Jan	-29,512	9,478		19,640	-8,470		0	-660	-555		7,911	-1,742	
Feb	12,292	47,268		-4,850	-6,650		0	-401	-60		6,772	74	
Mar	45,357	37,167		-16,170	24,025		10,000	-107	-1,409		3,869	-22,557	
	68,835	**1,64,601**	**72,947**	**12,080**	**36,435**	**-32,185**	**10,000**	**-3912**	**-5,125**	**-1909**	**35,148**	**-33,913**	**-22,054**

\# : Adjusted for revaluation.

\+ : Indicates injection of liquidity into the banking system.

\- : Indicates absorption of liquidity from the banking system.

@ : From April 2006 onwards, the Reserve Bank has stopped participating in the primary market for Government securities in line with the stipulations of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003.

Note : Data based on March 31 for March and last reporting Friday for all other months.

Table 3.5: Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item					2006-07			
	2003-04	2004-05	2005-06	2006-07	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9
A. Drivers of Liquidity (1+2+3+4+5)	**93,552**	**59,268**	**-31,696**	**61,739**	**36,247**	**-16,896**	**-25,641**	**68,028**
1. RBI's net purchases from Authorised Dealers	1,40,650	91,105	32,884	1,18,994	21,545	0	22,461	74,988
2. Currency with the Public	-43,390	-40,892	-57,256	-70,352	-19,648	-1,270	-27,033	-22,400
3. Surplus cash balances of the Centre with the Reserve Bank	-17,764	467	-22,726	-1,164	40,207	-26,199	-30,761	15,590
4. WMA/Overdraft to the Centre	0	0	0	0	0	0	0	0
5. Others (residual)	10,456	8,589	15,403	14,260	-5,856	10,574	9,693	-150
B. Management of Liquidity (6+7+8+9)	**-67,868**	**-57,896**	**57,969**	**-24,257**	**-39,003**	**32,026**	**31,625**	**-48,905**
6. Liquidity impact of LAF Repos	-32,230	15,315	12,080	36,435	-35,315	40,650	33,600	-2,500
7 Liquidity impact of OMO (Net) *	-39,138	0	10,740	720	545	145	25	5
8. Liquidity impact of MSS	0	-64,211	35,149	-33,912	-4,233	-8,769	4,750	-25,660
9. First round liquidity impact due to CRR change	3,500	-9,000	0	-27,500	0	0	-6,750	-20,750
C. Bank Reserves (A+B) #	**25,684**	**1,372**	**26,273**	**37,482**	**-2,756**	**15,130**	**5,984**	**19,123**

(+) : Indicates injection of liquidity into the banking system.
(-) : Indicates absorption of liquidity from the banking system.
: Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.
* : Adjusted for Consolidated Sinking Funds (CSF) and including private placement.
Note : Data pertain to March 31 and last Friday for all other months.

The Centre's surplus with the Reserve Bank rose to Rs.73,534 crore on December 22, 2006 from Rs.31,305 crore at end-November 2006 on account of receipts from auctioned Central Government securities as well as advance tax flows. Consequently, the LAF shifted from an absorption mode to injection mode from December 13, 2006 and remained so for the most of January 2007. Daily net injection of liquidity by the Reserve Bank averaged Rs.16,768 crore during December 13-31, 2006 and Rs.10,738 crore during January 2007. Amidst tightening of liquidity conditions, under-subscription in the MSS auctions and rejection of bids at market distorting yields resulted in the balances under the MSS declining to Rs.37,314 crore by end-December 2006 from Rs.42,364 crore at end-August 2006.

III.33 The LAF window switched back to the absorption mode from the second week of February 2007 till early March 2007 as liquidity conditions eased, partly reflecting the purchases of foreign exchange through market operations. The LAF window witnessed net absorption during February 8-March 4, 2007 except during February 15-20, 2007. Despite the cumulative increase in the CRR of one percentage point between December 23, 2006 and March 3, 2007, absorbing close to Rs.30,000 crore of banks' resources, the LAF continued to remain in sizeable absorption mode, indicating the continued prevalence of surplus liquidity in financial markets. On review, a two-pronged approach was, therefore, adopted on March 2, 2007 to deal with the large swings in liquidity. First, an enhanced MSS programme was put in place to restore LAF as a facility for equilibrating very short-term liquidity mismatches. Towards this objective, it was decided to use a mix of Treasury Bills and dated securities for MSS issuances in a more flexible manner keeping in view the capital flows, the assessment of volatility and durability of capital flows, and the paramount importance attached to liquidity management in containing inflation. Second, beginning March 5, 2007, daily reverse repo absorptions were restricted to a maximum of Rs.3,000 crore comprising Rs.2,000 crore in the First LAF and Rs.1,000 crore in the Second LAF.

III.34 Reflecting the modified arrangements, the balances under the LAF remained at around Rs.3,000 crore during March 5-15, 2007, while those under the MSS increased from Rs.42,807 crore at end-February 2007 to Rs.62,974 crore by March 31, 2007. Liquidity conditions, however, tightened from March 16, 2007 reflecting the increase in the Centre's cash balances (on the back of quarter-end advance tax outflows) as well as the effect of the CRR hike. Accordingly, the

Reserve Bank injected liquidity through repo operations, averaging Rs.32,091 crore during the second fortnight of March 2007. In view of inability of some banks to access the LAF repo window of the Reserve Bank due to the lack of surplus SLR securities in their portfolio, the overnight rates in the call money market exhibited significant upward pressure in the second half of March 2007. On March 21, 2007, the Reserve Bank clarified that banks could utilise the funds borrowed under the LAF repo facility for inter-bank lending, as such lending is part of normal money market functioning to enable day-to-day liquidity management by market participants with temporary mismatches. It was also stressed that the recourse to LAF by market participants should not be persistent in order to fund balance sheets for credit needs of customers. At the request of the market participants, the Reserve Bank conducted an additional LAF auction between 3.30 PM and 4.00 PM on March 31, 2007. The outstanding LAF repo amount was Rs.29,185 crore at end-March 2007 (Table 3.6).

III.35 During 2006-07, the Reserve Bank injected liquidity through repo operations on 64 days (78 days in 2005-06), while it absorbed liquidity through reverse repo operations on 244 days (same as a year ago) (Table 3.7). There was net injection of liquidity on 48 days and net absorption on 197 days during 2006-07 (67 days and 177 days, respectively, during 2005-06).

III.36 During the first quarter of 2007-08, financial markets experienced sizeable fluctuations in liquidity. The system shifted into a phase of large surplus liquidity from May 28, 2007 necessitating absorption through reverse repos on a daily basis. In view of the prevailing macroeconomic and overall monetary and liquidity conditions, the First Quarter Review of the Annual Statement on Monetary Policy for 2007-08 announced the withdrawal of the ceiling of Rs.3,000 crore on daily reverse repo under the LAF and the withdrawal of Second LAF with effect from August 6, 2007. The LAF reverse repo amount stood at Rs.13,885 crore on August 22, 2007.

Interest Rate Policy

III.37 Progressive deregulation of interest rates in those segments that have remained regulated for reasons relevant at different times has been engaging the attention of the Reserve Bank. Wide consultations have also been held with various stakeholders on the issue. While some interest rates continue to be regulated by the Reserve Bank, it has been the endeavour of the Reserve Bank to modify them in line with the changing scenario. The interest rate on savings bank deposits is regulated by the Reserve Bank and is currently prescribed at 3.5 per cent per annum; the rate was last revised on March 1, 2003. During 2006-07, the interest rate ceiling on NRE deposits was increased by 25 basis points in April 2006 but was reduced by 50 basis points in January 2007. Interest rate ceiling on FCNR(B) deposits was reduced by 25 basis points in January 2007. The

Table 3.6: Reserve Bank's Holdings of Central Government Dated Securities

(Rupees crore)

Year	Devolvement on Reserve Bank	Private Placement taken by Reserve Bank	OMO Purchases by Reserve Bank	Conversion of Special Securities into Dated Securities	Total Addition to Stock of Reserve Bank's Investments (2+3+4+5)	Open Market Sales by Reserve Bank	Net Addition to Stock (6-7)	Outstanding Holding by Reserve Bank (end period) *	Memo: Net Repo (+)/Reverse Repos (-) Out-standing #
1	2	3	4	5	6	7	8	9	10
1996-97	3,698	–	623	–	4,321	11,206	-6,885	6,666	-2,300
1997-98	7,028	6,000	467	20,000	33,495	8,081	25,414	31,977	-4,202
1998-99	8,205	30,000	–	–	38,205	26,348	11,857	42,212	-400
1999-00	–	27,000	1,244	–	28,244	36,614	-8,370	35,190	–
2000-01	13,151	18,000	4,471	–	35,622	23,795	11,827	41,732	-1,355
2001-02	679	28,213	5,084	–	33,976	35,419	-1,443	40,927	-4,355
2002-03	5,175	31,000	–	40,000	76,175	53,780	22,395	55,438	-2,415
2003-04	–	21,500	–	61,818	83,318	41,849	41,469	77,397	-34,645
2004-05	847	350	–	–	1,197	2,899	-1,702	80,770	-19,330
2005-06	–	10,000	740	–	10,740	4,653	6,087	83,205	-7,250
2006-07	–	–	720	–	720	5,845	-5,125	75,537	29,185

* : Inclusive of transactions under the LAF. # : Data pertain to end-March.

Table 3.7: Reverse Repo/Repo Bids under LAF

Year/Month	Reverse Repo					Repo				
	No. of days bids were received	No. of days all bids were rejected	No. of days of full acceptance of bids	No. of days with less than full acceptance of bids	No. of days of partial acceptance of bids	No. of days bids were received	No. of days all bids were rejected	No. of days of full acceptance of bids	No. of days with less than full acceptance of bids	No. of days of partial acceptance of bids
1	2	3	4	5	6	7	8	9	10	11
2004-05	**242**	**0**	**242**	**0**	**0**	**23**	**0**	**23**	**0**	**0**
2005-06	**244**	**0**	**244**	**0**	**0**	**78**	**0**	**76 @**	**2**	**0**
2006-07	**244**	**0**	**234**	**0**	**10**	**64**	**0**	**63 @**	**1**	**0**
April	17	0	17	0	0	3	0	2 @	1	0
May	22	0	22	0	0	0	0	0	0	0
June	22	0	22	0	0	0	0	0	0	0
July	21	0	21	0	0	0	0	0	0	0
August	22	0	22	0	0	0	0	0	0	0
September	21	0	21	0	0	2	0	2	0	0
October	19	0	19	0	0	6	0	6	0	0
November	22	0	22	0	0	0	0	0	0	0
December	20	0	20	0	0	13	0	13	0	0
January	20	0	20	0	0	20	0	20	0	0
February	18	0	18	0	0	9	0	9	0	0
March	20	0	10	0	10	11	0	11	0	0
2007-08										
April	19	0	11	0	8	15	0	15	0	0
May	21	0	12	0	9	14	0	14	0	0
June	21	0	2	0	19	2	0	2	0	0
July	21	0	0	0	21	0	0	0	0	0

@ : Number of days of full acceptance of bid was less than the number of days bids were received on account of non-acceptance of one bid each on technical grounds on January 24, 2006, March 23, 2006 and April 4, 2006.

Note : 1. With effect from October 29, 2004, the nomenclature of repo and reverse repo was changed in keeping with international usage. Now, reverse repo indicates absorption of liquidity and repo signifies injection of liquidity. Prior to October 29, 2004, repo indicated absorption of liquidity while reverse repo meant injection.

2. With effect from November 2005, the data are inclusive of the Second LAF.

3. Between March 5 and August 5, 2007, daily reverse repo absorptions were restricted to a maximum of Rs.3,000 crore comprising Rs.2,000 crore in the First LAF and Rs.1,000 crore in the Second LAF.

ceiling interest rates on NRE deposits and FCNR(B) deposits were reduced by 50 basis points in April 2007 (see Table 3.2).

III.38 The validity of the reduction in the interest rate ceiling to 250 basis points below the benchmark prime lending rate (BPLR) on pre-shipment rupee export credit up to 180 days and post-shipment rupee export credit up to 90 days, announced on September 24, 2001, has been extended up to October 31, 2007. On the basis of the recommendations of the Working Group to Review Export Credit, the ceiling interest rate on export credit in foreign currency was increased by 25 basis points to LIBOR *plus* 100 basis points with effect from April 18, 2006 (Appendix Table 57).

III.39 On July 12, 2007, the Government announced a package of measures to provide relief for a temporary period in terms of interest rate subvention of 2 percentage points per annum on rupee export credit availed of by exporters in nine categories of exports, *viz.,* textiles (including handlooms), readymade garments, leather products, handicrafts, engineering products, processed agricultural products, marine products, sports goods and toys and to all exporters from the SME sector defined as micro enterprises, small enterprises and medium enterprises. Accordingly, the Reserve Bank indicated that banks would charge interest rate not exceeding BPLR *minus* 4.5 per cent on pre-shipment credit up to 180 days and post-shipment credit up to 90 days on the outstanding amount for the period Apirl 1, 2007 to December 31, 2007 to all SME sectors and the nine sectors as mentioned above.

MONETARY POLICY OPERATIONS: 2007-08

Annual Policy Statement for 2007-08

III.40 At the time of announcement of the Annual Policy Statement for 2007-08 (April 24, 2007), global growth was strong, although it was expected to moderate in 2007 relative to 2006. Inflationary pressures were evident globally along with elevated levels of commodity and asset prices. In the global financial markets, the risks, including geopolitical risks, remained under-priced and diffused. On the domestic front, there was evidence of some cyclical elements though a significant structural change was taking place in the Indian economy. There was a gathering confidence that the economy was possibly poised on the threshold of a step-up in the growth trajectory. However, demand pressures appeared to have intensified alongside robust growth and there were increased supply side pressures in evidence. The Annual Policy Statement observed that international trade could not, by its nature, fully mitigate all supply side issues among all sectors and it was prudent to recognise that the first effects of the expansion in demand would be reflected in inflationary pressures and risks to macroeconomic and financial stability. The Annual Policy Statement also observed that these factors had been in evidence in the form of sustained demand for capital goods and consumer durables, high rates of money and credit, indications of wage pressures in some sectors, rising input costs and the emergence of pricing power. Against this backdrop, the Annual Policy Statement noted that the overarching policy challenge was to manage the transition to a higher growth path while containing inflationary pressures.

III.41 For policy purposes, real GDP growth for 2007-08 in the Annual Policy Statement was placed at around 8.5 per cent, assuming no further escalation in international crude prices and barring domestic or external shocks. In view of the lagged and cumulative effects of monetary policy on aggregate demand and assuming that supply management would be conducive, capital flows would be managed actively and in the absence of shocks emanating in the domestic or global economy, the policy endeavour would be to contain inflation close to 5.0 per cent in 2007-08. The Statement noted that there were indications that the Reserve Bank's self-imposed medium-term ceiling on inflation at 5.0 per cent had had a salutary effect on inflation expectations and the socially tolerable rate of inflation had come down. In recognition of India's evolving integration with the global economy and societal preferences in this regard, the Statement added that resolve, going forward, would be to condition policy and perceptions for inflation in the range of 4.0–4.5 per cent. This objective would be conducive for maintaining self-accelerating growth over the medium-term.

III.42 In view of money supply growth remaining well above indicative projections in 2005-06 and 2006-07, the need to contain monetary expansion in 2007-08 at around 17.0-17.5 per cent in consonance with the outlook on growth and inflation was emphasised. Consistent with the projections of money supply, the growth in aggregate deposits in 2007-08 was placed at around Rs.4,90,000 crore. Based on an overall assessment of the sources of funding, a graduated deceleration of non-food credit including investments in bonds/debentures/shares of public sector undertakings and private corporate sector and commercial paper (CP) to 24.0-25.0 per cent in 2007-08 from the average of 29.8 per cent over 2004-07 was consistent with the monetary projections.

III.43 The Annual Policy Statement observed that the stance of monetary policy in 2007-08 would be conditioned by the patterns in which the global and, more particularly, the domestic environment unfold. The likely evolution of macroeconomic and financial conditions indicated an environment supportive of sustaining the current growth momentum in India. The Statement reiterated that monetary policy, while contributing to growth, had to ensure and maintain conditions of price and financial stability. Accordingly, the policy preference for the period ahead was articulated strongly in favour of reinforcing the emphasis on price stability and anchoring inflation expectations (see Box III.2).

First Quarter Review

III.44 In the First Quarter Review of the Annual Statement on Monetary Policy (July 31, 2007), the Reserve Bank observed that the prospects for growth in 2007-08 appeared positive. In the backdrop of IMD's forecast of normal rainfall for the country as a whole, a return to trend growth in agriculture was expected. Growth in industrial and service sector activity was expected to be sustained. Overall, for policy purposes, the projection of real GDP growth for 2007-08 was retained at around 8.5 per cent, barring domestic or external shocks.

III.45 The Review noted that there were indications that the combination of lagged and cumulative effects of monetary policy actions and fiscal and administrative measures for supply management had had a salutary effect on inflation expectations. However, monetary management would need to be watchful of movements in commodity prices, particularly oil prices, the elevated levels of asset prices and the re-emergence of pricing power among producers as potential threats to inflation expectations. Assuming that aggregate supply management would continue to receive public policy attention and that a more active management of the capital account would be demonstrated, the outlook for inflation in 2007-08 remained unchanged in the Review. While non-food credit growth had decelerated, the acceleration in money supply and reserve money warranted an appropriate response.

III.46 The Review observed that the global outlook was positive with continuing prospects for strong and stable growth but there were concerns about inflationary pressures worldwide. Monetary authorities were inclined to regard the current levels of real interest rates as warranting further withdrawal of monetary accommodation and were indicating a preparedness to respond to the manner in which the inflation scenario evolves. The Review added that financial markets had been aggressively re-pricing risks; however, the wide diffusion of risks and the abundance of liquidity had imparted considerable uncertainty. Visitations of volatility in equity and currency markets with worldwide ramifications had imparted an additional dimension of uncertainty to the evolution of the international economic environment.

III.47 These developments were necessitating intensified policy monitoring with a policy preference for insulating domestic real activity from these shocks. Looking ahead, the Review noted that monetary policy in India would continue to be vigilant and pro-active in the context of any accentuation of global uncertainties that posed threats to growth and stability in the domestic economy. The domestic outlook continued to be favourable and would dominate the dynamic setting of monetary policy in the period ahead. It was important to design monetary policy such that it protects growth by contributing to the maintenance of stability. Accordingly, while the stance of monetary policy would continue to reinforce the emphasis on price stability and well-anchored inflation expectations and thereby sustain the growth momentum, contextually, financial stability may assume greater importance in the months to come. Keeping the above in view, recent developments in financial markets in India and potential uncertainties in global markets warranted a higher priority for managing appropriate liquidity conditions in the policy hierarchy. Accordingly, the Review stated that the Reserve Bank would continue with its policy of active demand management of liquidity through appropriate use of the CRR stipulations and open market operations (OMO) including the MSS and LAF, using all the policy instruments at its disposal flexibly, as and when the situation warrants.

CREDIT DELIVERY

III.48 For ensuring effective credit delivery, the thrust of the Reserve Bank's efforts in recent years has been on strengthening and empowering regional rural banks (RRBs), reforming cooperatives, expanding the purview of the priority sector, modifying the prudential norms and simplifying the procedures in the case of agricultural loans. During 2006-07, the Reserve Bank continued to take steps to improve credit delivery mechanism for small borrowers in order to bring about maximum financial inclusion of the poorer sections of the society. The guidelines on lending to the priority sector were revised based on the draft Technical Paper submitted by the Internal Working Group on Priority Sector Lending (Chairman: Shri C.S. Murthy) and the feedback received thereon (Box III.5). Employment-intensive sectors such as agriculture, and micro and small enterprises – which impact large and weaker sections of the population – have been retained as priority sector in the revised guidelines which became effective from April 30, 2007. The broad categories of advances included in the priority sector are agriculture, small enterprises, micro credit, retail trade, education loans and housing loans up to Rs 20 lakh.

Financial Inclusion

III.49 The Reserve Bank has taken several initiatives to provide smooth and efficient banking services to the general public at large. Efforts towards 'financial inclusion' include sensitising the banks to the banking and financial needs of the common person and ensuring access to basic banking facilities (Box III.6).

Financial Literacy

III.50 With a view to educating the general public as also the existing customers of banks about the various financial products and services that are available in the market/offered by the banks, the Reserve Bank has initiated the process of financial education. A Steering Group on Reaching Out to the

Box III.5
Revised Guidelines on Priority Sector Lending

The revised guidelines on lending to the priority sector, effective April 30, 2007 seek to enlarge the base of the priority sector lending. The targets and sub-targets for the priority sector lending would henceforth be linked to adjusted net bank credit (ANBC) (net bank credit *plus* investments made by banks in non-SLR bonds held in HTM category) or credit equivalent amount of off-balance sheet exposures (OBE), whichever is higher, as on March 31 of the previous accounting year. The outstanding FCNR (B) and NRNR deposits balances will no longer be deducted for computation of ANBC for priority sector lending purposes. The broad categories of the priority sector for all scheduled commercial banks will be as under:

(i) **Agriculture (Direct and Indirect Finance):** Direct finance to agriculture shall include short, medium and long-term loans given for agriculture and allied activities (such as dairy, fishery, piggery, poultry, beekeeping) directly to individual farmers, self-help groups (SHGs) or joint liability groups (JLGs) of individual farmers without limit and to others (such as corporates, partnership firms and institutions) up to the specified limits for taking up agriculture/allied activities. Indirect finance to agriculture shall include loans given for specified entities in the areas of agriculture and allied activities.

(ii) **Small Enterprises (Direct and Indirect Finance):** Direct finance to small enterprises shall include all loans given to micro and small enterprises, engaged in both manufacturing (production, processing or preservation of goods) and services activities, and whose investment in plant and machinery and equipment does not exceed the specified amounts. The micro and small (service) enterprises will include small road and water transport operators, small business, professional and self-employed persons, and certain other service enterprises. Indirect finance to small enterprises shall include finance to any person providing inputs to or marketing the output of artisans, village and cottage industries, handlooms and to cooperatives of producers in this sector.

(iii) **Retail Trade** shall include retail traders/private retail traders dealing in essential commodities (fair price shops), and consumer co-operative stores.

(iv) **Micro Credit** shall include provision of credit and other financial services and products of very small amounts not exceeding Rs.50,000 per borrower, either directly or indirectly through a SHG/JLG mechanism or to NBFC/MFI for on-lending up to Rs.50,000 per borrower.

(v) **Education Loans** shall include loans and advances granted to individuals (but not to institutions) up to Rs.10 lakh for studies in India and Rs.20 lakh for studies abroad.

(vi) **Housing Loans** shall include loans up to Rs.20 lakh to individuals for purchase/construction of one dwelling unit per family (excluding loans granted by banks to their own employees) and loans given for repairs to the damaged dwelling units of families up to Rs.1 lakh in rural and semi-urban areas and up to Rs.2 lakh in urban and metropolitan areas.

Common Man was constituted in the Reserve Bank for initiating the financial education programme. A multilingual website in 13 languages on all matters concerning banking and the common person was launched by the Reserve Bank on June 18, 2007 (Box III.7). Furthermore, financial literacy programmes are also being launched in each State with the active involvement of the State Governments and the State Level Bankers' Committees (SLBC).

Pilot Project for 100 per cent Financial Inclusion

III.51 Convenor banks of State Level/Union Territory Level Bankers' Committees (SLBC/UTLBC) in all States/Union Territories were advised in April 2006 to identify suitable districts and allocate villages to banks operating in their respective States/Union Territories for ensuring 100 per cent financial inclusion, with the progress thereof to be monitored in the SLBC/UTLBC meetings. So far 104 districts have been identified and 100 per cent financial inclusion has been achieved in the Union Territory of Puducherry and in 24 districts in Andhra Pradesh, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala and Punjab. Notably, all districts of Himachal Pradesh have achieved financial inclusion. An evaluation of the progress made in achieving financial inclusion in these districts is being undertaken to draw lessons for further action in this regard. As a result of the measures taken for financial inclusion, there was an increase of 6 million new 'no frills' bank accounts between March 2006 and March 2007.

Services to Depositors and Small Borrowers in Rural and Semi-Urban Areas

III.52 The Annual Policy Statement for the year 2005-06 proposed a survey for assessing customer satisfaction on credit delivery in rural areas by banks. Accordingly, the National Council of Applied Economic

Box III.6
Financial Inclusion

Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. As banking services are in the nature of a public utility service, it is essential that banking and payment services are provided to the entire population without discrimination.

The Reserve Bank's broad approach to financial inclusion has been aimed at "connecting" people with the banking system and enabling them to access the payments system and not just higher credit dispensation. The Reserve Bank has adopted a decentralised approach in this regard with close involvement of the State Governments and banks and used multiple channels, *inter alia*, civil service organisations, NGOs, post offices, farmers' clubs, panchayats and MFIs as business facilitators to expand the outreach of banks.

A simple benchmark employed to assess the degree of reach of financial services is the number of deposit accounts (current and savings) held as a ratio to adult population. In the Indian context, the ratio of deposit accounts as on March 31, 2004 to total adult population as per 2001 census was only 59 per cent. The ratio varied across States, ranging from 89 per cent in Kerala to 21 per cent in Nagaland. The spread of banking facilities is, thus, uneven in the country, with a substantial proportion of the households, especially in rural areas, still outside the coverage of the formal banking system. Almost 40 per cent of the adult population of the country, comprising mainly those living on low incomes and those without pre-owned collaterals, is unable to access mainstream financial products such as bank accounts and low cost loans. Such households are likely to use the informal credit markets, often at high interest rates, contributing to spiralling debt.

The Reserve Bank has, therefore, taken a number of measures in recent years to tackle financial exclusion by enhancing access to banking services including the following:

- Banks have been urged to make available a basic banking 'no frills' account either with 'nil' or very low minimum balances as well as charges that would make such accounts accessible to vast sections of the population. Regional Rural Banks have also been advised to allow limited overdraft facilities in 'no frills' accounts, without any collateral.
- Banks are required to make available all printed material used by retail customers in the concerned regional language.
- All State Level Bankers' Committee (SLBC) convener banks have been advised to initiate action for identifying at least one district in their State/Union Territory for, 100 per cent financial inclusion.
- The 'know your customer' (KYC) procedure for opening 'no frills' accounts has been simplified so that people from low-income groups do not face problems in opening new accounts.
- Banks have been asked to consider introducing a General Purpose Credit Card (GCC) facility in the nature of revolving credit up to Rs.25,000 without insisting on security or purpose at deregulated interest rates at their rural and semi-urban branches. Fifty per cent of the GCC loans are treated as part of the banks' priority sector lending (indirect finance to agriculture).
- Guidelines have been issued to banks to enhance their outreach by utilising the 'business facilitators' and 'business correspondents' models. Banks are also entering into agreements with Indian postal authority for using the wide network of post offices as business correspondents.
- Banks are encouraged to make use of information and communication technology (ICT) using bio-metric smart cards and mobile hand held electronic devices for receipts and disbursement of cash by their agents such as business facilitators/correspondents.

The recommendations of the Working Groups constituted by the Reserve Bank to suggest measures for enhancing provision of banking services, strengthening financial institutions and improving currency and payments systems in under-banked regions of the country such as the North-Eastern Region, Chattisgarh, Uttarakhand and Bihar are also under implementation.

Research (NCAER) was entrusted to carry out a study on the quality of services rendered by branches of commercial banks to their customers (both depositors and small borrowers) in rural and semi-urban areas. The NCAER, which initiated a study in January 2006, submitted a draft report in January 2007. The study covered 930 bank branches across the country from 30 States/Union Territories, and included 9,300 depositors and 13,950 borrowers. Prompt service delivery at the counter and professional attitude of the bank staff in reaching out to the customers emerged as key determinants for customer satisfaction in rural and semi-urban areas.

Credit Counselling: Setting up of Centres on a Pilot Basis

III.53 In the light of the recommendations made by two Working Groups set up by the Reserve Bank, convenor banks of the State/Union Territory Level Bankers' Committees (SLBCs/UTLBCs) were advised

Box III.7
Financial Education

Financial education is the process by which financial consumers/investors improve their understanding of financial products and concepts, and develop the skills and confidence to make informed choices to improve their financial well-being. With increasing globalisation, the difference in the pace of growth of the financial sector and financial education can be minimised through three approaches, *viz.*, institutional mechanisms, delivery mechanisms and decentralisation of efforts (Reddy, 2006).

Financial education has assumed importance in recent years, as financial markets have become increasingly complex. Moreover, with information asymmetry, it is increasingly difficult for the common person to make informed choices. Therefore, central banks the world over have undertaken various initiatives towards financial education. The initiatives range from comic books and animation films to arranging exhibitions and competitions for school children as also giving them tours of the central bank so that they understand its role in the well-being of the country's economy as also appreciate concepts such as savings, investment and financial planning.

In India, the need for financial education is even greater considering the low levels of literacy and a large section of the population being still out of the formal financial set up. Furthermore, economic and financial sector reforms have placed higher disposable incomes in the hands of the public. Availability of a variety of new financial products on both, credit and investment sides which are provided by a host of financial intermediaries, has necessitated that the investing public understand the nuances of each product and product supplier and take an informed decision about investments. At the same time, those who are not a part of the formal financial system need to be educated about what banking is and why they should have a relationship with banks so that they also participate in and benefit from the growth process. Financial education, in other words, is considered an important element for promoting financial inclusion as also financial stability.

The Reserve Bank has undertaken a project titled "Project Financial Literacy". The objective of this project is to disseminate information regarding the central bank and general banking concepts to various target groups, including school and college going children, women, rural and urban poor, defence personnel and senior citizens. The project, which envisages a multi-pronged approach, has been designed to be implemented in two modules – one module focusing on the economy, the Reserve Bank and its activities, and the other module on general banking. The material will be created in English and Hindi, and will be adapted in regional languages. It would be disseminated to the target audience with the help, among others, of banks, local government machinery, schools and colleges through presentations, pamphlets, brochures, films, as also through the Reserve Bank's website. The Reserve Bank has also created a sub-site for the common person to give him the ease of access to information for use in dealings with banks. The sub-site is in 13 regional languages. The Reserve Bank has also been endeavouring to reach out the common person through several other channels. For instance, the Hyderabad office of the Reserve Bank has formulated a multi-modal (informative display through posters, brochures, multi-media presentations, video films, demonstrations, computer games), multi-lingual (English, Hindi, Telugu and Urdu) and customised interactive strategies (like stalls in exhibitions, visits to schools, colleges, villages, meeting with bankers, traders, farmers, SHGs, tour of the Reserve Bank) for spreading financial literacy among the common persons in general and school children, college students, farmers, women and villagers in particular.

References

1. OECD (2005), Improving Financial Literacy, Analysis of Issues and Policies.
2. Reddy, Y.V.(2006), "The Role of Financial Education: The Indian Case", *Reserve Bank of India Bulletin*, March.

in May 2007 to set up, on a pilot basis, a financial literacy-cum-counselling centre in any one district in the State/ Union Territory coming under their jurisdiction (Box III.8).

IT-enabled Financial Inclusion

III.54 As announced in the Annual Policy Statement for the year 2007-08, banks have been urged to scale up information technology (IT) initiatives for financial inclusion speedily while ensuring that solutions are highly secure, amenable to audit, and follow widely-accepted open standards to ensure eventual inter-operability among the different systems.

Special Drive for Financial Inclusion in Scheduled Caste/ Scheduled Tribe and Minorities Concentrated Districts

III.55 With a view to according priority to the most needy, a special drive has been initiated by the Regional Offices of the Reserve Bank for 100 per cent financial inclusion in the districts with maximum concentration of Scheduled Castes (SCs)/ Scheduled Tribes (STs) and minorities. For this purpose, the Regional Offices have been advised to use a list of 121 minority concentrated districts forwarded by the Ministry of Finance, Government

Box III.8
Credit Counselling Centres

Access to quality financial services has a decisive influence on the economic well-being of all. The absence of proper credit counselling coupled with inadequate financial literacy levels have often resulted in the consumers being forced towards costlier options and eventual debt traps. Given the growing indebtedness, there is an increasing need to develop follow-up services to enable distressed borrowers to overcome credit delinquencies. It will, therefore, be in the interest of banks themselves to help individual borrowers through appropriate credit counselling (Reddy, 2006).

A few banks have taken initiatives to set up some centres in rural/semi-urban areas to offer financial education and credit counselling services. The objective of these centres is to advise people on gaining access to the financial system including banks, creating awareness among the public about financial management, counselling people struggling to meet the repayment obligations and helping in rehabilitation of borrowers in distress. Some of these credit counselling centres (also known as Knowledge Centres) also train farmers/women groups to enable them to start their own income generating activities to earn a reasonable livelihood.

The Working Group to Suggest Measures for Assisting Distressed Farmers (Chairman: Prof.S.S.Johl) had recommended that financial and livelihood counselling are important for increasing the viability of credit. Furthermore, the Working Group to Examine Procedures and Processes for Agricultural Loans (Chairman: Shri C.P.Swarnkar) also recommended that banks should actively consider opening counselling centres, either individually or with pooled resources, for credit and technical counselling with a view to giving special thrust in the relatively under-developed regions. In the light of the recommendations of these two groups, the convenor banks of the State/Union Territory Level Bankers' Committees were advised in May 2007 to set up, on a pilot basis, a financial literacy-cum-counselling centre in any one district in the State/Union Territory, coming under their jurisdiction. On the basis of the experience gained, the concerned lead banks were advised to set up such centres in other districts.

Reference:

Reddy,Y.V. (2006), 'Credit Counselling: An Indian Perspective', *Reserve Bank of India Bulletin*, March.

of India together with Census/other data on SCs/STs and minorities. The Reserve Bank has so far identified eight such districts (four in Maharashtra, three in Tamil Nadu and one in Haryana) for 100 per cent financial inclusion.

Working Groups on Improvement of Banking Services in Different States

III.56 The Reserve Bank had in the recent period constituted Working Groups to suggest measures for improving the outreach of banks and their services, and promoting financial inclusion in certain States (North-Eastern Regions, Uttarakhand, Bihar and Chattisgarh) and for supporting the development plans of the State Governments. The reports submitted by these Groups have been found very useful from several points of view. First, they have examined the adequacy of banking services in the context of the respective State's development plan and tried to plug the gaps. Second, they have thrown up a host of constructive suggestions towards enhancing the outreach of banks and promoting financial inclusion, keeping in view the regional requirements, resources and opportunities. Third, the studies undertaken have also made useful suggestions for revitalisation of the regional rural banks and urban cooperative banks in the respective regions. Finally, the studies, which have been jointly done by the Reserve Bank, the concerned State Governments, NABARD, banks and financial institutions, have provided a renewed impetus to the initiatives to bring about improvements in the economies of the respective States.

III.57 A Working Group to undertake a study of the banking services in the Union Territory of Lakshadweep has been constituted. The Group, chaired by the Regional Director of the State of Kerala and the Union Territory of Lakshadweep, will have representatives of the Union Territory's Government, NABARD, SIDBI and the SLBC convenor bank.

III.58 A Working Group has also been constituted, under the chairmanship of the Regional Director (of the Reserve Bank) of the States of Punjab and Himachal Pradesh and Union Territory of Chandigarh, to review the role of banks and financial institutions in supporting the initiatives taken by the State Government of Himachal Pradesh for promoting economic development of the State and also to recommend measures for enhancing greater outreach/penetration of the banking system in the State. The Group will have representatives from State Government of Himachal Pradesh, NABARD, SIDBI and the SLBC convenor bank.

Committee on Financial Sector Plan for North Eastern Region (NER)

III.59 In order to achieve greater financial inclusion and provision of financial services in the North Eastern Region (NER) and also to prepare an appropriate as well as monitorable action plan for the region, the Reserve Bank had set up a Committee on Financial Sector Plan (CFSP) for North Eastern Region (Chairperson: Smt. Usha Thorat). The Committee submitted its report in July 2006. A High Level Monitoring Group has been constituted to oversee the implementation of the recommendations of the CFSP in the North Eastern Region.

III.60 On request from the Government of India to include the State of Sikkim while reviewing the credit flow from banks in the North Eastern region, a Task Force for the State of Sikkim was constituted under the chairmanship of the Regional Director (of the Reserve Bank) of West Bengal and Sikkim, to recommend Action Plan for the State of Sikkim to the CFSP. The Task force forwarded its report on June 22, 2007 to all the stakeholders for implementation of the recommendations.

Relief Measures for Distressed Farmers

III.61 As announced in the Annual Policy Statement for the year 2006-07 (April 2006), a Working Group was constituted under the Chairmanship of Prof. S.S. Johl to suggest measures for assisting distressed farmers, including provision of financial counselling services and introduction of a specific Credit Guarantee Scheme by the Deposit Insurance and Credit Guarantee Corporation (DICGC) for such farmers. The Group submitted its report in November 2006. In the light of the recommendations of the Working Group and in order to assist distressed farmers whose accounts had earlier been rescheduled/converted on account of natural calamities as also farmers defaulting on their loans due to circumstances beyond their control, banks were advised to frame transparent one time settlement (OTS) policies for such farmers, with the approval of their boards. The remaining recommendations of the Group are under examination.

Guidelines for Relief to Farmers

III.62 Pursuant to the announcement made by the Union Finance Minister in the budget speech for the year 2006-07, commercial banks were advised to grant interest relief of two percentage points in the interest rate on the principal amount up to Rs 1 lakh on each crop loan granted by them during *kharif* and *rabi* of 2005-06, and credit the relief to the borrower's account before March 31, 2006. Furthermore, the Government decided to ensure that the farmers receive short-term credit at 7 per cent rate of interest on loans up to Rs.3,00,000 on the principal amount with effect from *kharif* 2006-07. The public sector banks and the regional rural banks were advised that the Government would provide interest rate subvention of 2 per cent per annum to them in respect of short-term production credit up to Rs.3,00,000 provided to farmers. The Union Finance Minister in his budget speech for the year 2007-08 announced that the two per cent subvention scheme for short-term crop loans would continue for the year 2007-08 also.

Internal Working Group on Special Relief Measures by Banks in Areas Affected by Natural Calamities

III.63 In view of certain practical problems relating to functioning of ATMs, opening of accounts of small customers, operations of accounts in the absence of documents and failure of computer networks, being faced by the banking community during calamities such as tsunami, heavy rains, floods and earthquakes in some parts of the country, the Reserve Bank had constituted an Internal Working Group to suggest suitable revisions and additions to the existing guidelines. The Working Group submitted its final report on June 12, 2006. Based on the recommendations of the Group, the Reserve Bank issued certain additional guidelines to banks on August 9, 2006.

Package of Relief Measures to the Vidarbha Region in Maharashtra

III.64 In order to mitigate distress of farmers in the six debt-ridden districts in the Vidarbha region of Maharashtra, the Prime Minister had announced a rehabilitation package. Under the package, the entire interest on overdue loans as on July 1, 2006 was waived in the six debt-ridden districts (Amravati, Wardha, Yavatmal, Akola, Washim and Buldhana) so that they will be immediately eligible for fresh loans from the banking system. The overdue loans of the farmers as on July 1, 2006 were rescheduled over a period of 3-5 years with one year moratorium. The package also envisaged that an additional credit flow of Rs.1,275 crore would be ensured in these six districts. Under this package, the burden of waiver of overdue interest would be shared equally by the State and Central Governments. While apportioning the overdue interest as above, due care is required to be taken to offset releases, if any, already made by the State Government in this regard. The total amount of credit of Rs.1,275 crore envisaged to be released by banks has been allocated by Bank of Maharashtra (as the SLBC Convenor) among the banks functioning in the districts. The Government of India has sanctioned Rs 356 crore for reimbursing the banks towards waiver of interest in the above districts of Vidarbha.

Package for 25 Debt Stressed Districts of Andhra Pradesh, Karnataka and Kerala

III.65 The Government of India has approved a package for mitigating the distress of farmers in 25 debt stressed districts of Andhra Pradesh, Karnataka and Kerala[1]. The package has the following elements relating to agricultural credit: First, the entire interest on overdue loans as on July 1, 2006 will be waived off in the 25 affected districts and all farmers will have no past interest burden as on that date, so that they will immediately be eligible for fresh loan from the banking system. Second, the overdue loans of the farmers as on July 1, 2006 will be rescheduled over a period of 3-5 years with one-year moratorium. Finally, credit flow of Rs.13,818 crore, Rs.3,076 crore and Rs.1,945 crore will be ensured in the affected districts of Andhra Pradesh, Karnataka and Kerala, respectively, in 2006-07. Instructions in this regard have been issued to banks. The Government of India has sanctioned Rs.718 crore, Rs.105 crore and Rs.180 crore for reimbursing the banks towards waiver of interest in the above States.

Working Group on Simplification of the Procedures and Processes for Obtaining Agricultural Loans

III.66 The Reserve Bank had constituted a Working Group to suggest measures to further simplify the procedures so as to reduce the cost and time for obtaining agricultural loans, especially by small and marginal farmers. Three recommendations of the Group, *viz.*, dispensing with no dues certificate (NDC) for small loans up to Rs.50,000; considering opening of counselling centres; and extending credit to the landless labourers, share-croppers and oral lessees based on the certificates provided by local administration/Panchayati Raj institutions were accepted and banks were advised accordingly.

Technical Group for Review of Legislations on Money Lending

III.67 As announced in the Annual Policy Statement for the year 2006-07, a Technical Group was set up to review the efficacy of the existing legislative framework governing money lending and its enforcement machinery in different States and make recommendations to the State Governments for improving the legal and enforcement framework in the interest of rural households. The Group has since submitted its report which has been placed in the public domain. A model legislation on money lending has been prepared by the Group for consideration and adoption by the State Governments that do not presently have a comprehensive legislation in place for governing money lending. The model legislation provides for a hassle free procedure for compulsory registration and periodical renewal by money lenders; a simplified dispute resolution mechanism to ensure better enforcement; periodic fixing of the maximum interest rate in line with market rates; and adoption of rule of *Damdupat* restricting maximum amount of interest chargeable by the money lender. The Group has also explored establishment of a link between the formal and informal credit providers whereby a money lender who is an ‘Accredited Loan Provider’ may serve as an additional credit delivery channel for the formal sector, provided there are safeguard measures.

Priority Sector Lending

III.68 Domestic banks and foreign banks are required to provide 40 per cent and 32 per cent, respectively, of their net bank credit to the priority sector. All bank groups achieved the overall target for priority sector lending as on the last reporting Friday of March 2006. As on the last reporting Friday of March 2007, public sector banks fell short of the target of 40 per cent by 0.4 percentage point, while private sector banks and foreign banks, as groups, achieved the overall lending target (Table 3.8). Six out of 28 public sector banks, four out of 26 private sector banks and five out of 29 foreign banks could not achieve their priority sector lending target as on the same date.

Credit to Agricultural Sector

III.69 In order to improve the flow of credit to the agricultural sector, the Reserve Bank had advised

[1] The districts covered under this scheme are Prakasam, Guntur, Nellore, Chittoor, Kadapa, Anantapur, Kurnool, Adilabad, Karimnagar, Khammam, Mahaboobnagar, Medak, Nalgonda, Nizamabad, Rangareddy and Warangal in Andhra Pradesh; Belgaum, Hassan, Chitradurga, Chikmaglur, Kodagu and Shimoga in Karnataka; and Wayanad, Palakkad, and Kasaragod in Kerala.

Table 3.8: Priority Sector Advances

(Amount in Rupees crore)

As on Last Reporting Friday	Public Sector Banks	Private Sector Banks	Foreign Banks
1	2	3	4
March 2003	1,99,786 (41.2)	36,648 (44.1)	14,555 (33.1)
March 2004	2,44,456 (43.6)	48,920 (47.3)	17,960 (34.1)
March 2005	3,07,046 (42.8)	69,886 (43.6)	23,843 (35.3)
March 2006	4,09,748 (40.3)	1,06,586 (42.8)	30,439 (34.4)
March 2007*	5,21,180 (39.6)	1,43,768 (42.7)	37,835 (33.4)

* : Provisional.

Note: 1. Figures in parentheses are percentages to the net bank credit in the respective groups.

2. The target for aggregate advances to the priority sector is 40 per cent and 32 per cent of the net bank credit for domestic banks and foreign banks, respectively.

Table 3.9: Disbursements by Banks under Special Agricultural Credit Plans

(Amount in Rupees crore)

Year	Target	Disbursements	Achievement of Target (Per cent)	Annual Growth in Disbursements (Per cent)
1	2	3	4	5
Public Sector Banks				
2000-01	25,893	25,654	95.2	12.5
2001-02	30,883	29,332	95.0	19.0
2002-03	36,838	33,921	92.1	15.6
2003-04	42,576	42,211	99.1	24.4
2004-05	55,616	65,218	117.3	54.5
2005-06	85,024	94,278	110.9	44.6
2006-07	1,18,160	1,22,215 *	103.4 *	29.6 *
Private Sector Banks				
2005-06	24,222	31,199	128.8	
2006-07	40,656	18,819 *	46.3 *	

* : Provisional.

public sector banks to prepare Special Agricultural Credit Plans (SACP) in 1994-95. The SACP mechanism was also made applicable to private sector banks in 2005-06. The disbursements by public sector banks to agriculture under the SACP rose by 44.6 per cent during 2005-06, exceeding the target by almost 11 per cent. The disbursements by private sector banks also exceeded the target by almost 29 per cent during 2005-06. During 2006-07, the disbursements to agriculture under the plan by public sector banks aggregated Rs.1,22,215 crore (provisional) against a target of Rs.1,18,160 crore (Table 3.9).

III.70 The Union Finance Minister in his budget speech for the year 2006-07 had asked the banks (including co-operative banks and RRBs) to disburse Rs.1,75,000 crore as credit to the agricultural sector during 2006-07 as compared with the targets of Rs.1,41,000 crore for 2005-06 and Rs.1,05,000 crore for 2004-05. The actual disbursements by banks exceeded the targets in each of the three years, amounting to Rs 2,03,296 crore during 2006-07, Rs.1,80,486 crore during 2005-06 and Rs.1,25,309 crore during 2004-05. During 2006-07, 8.35 million new farmers were brought under the institutional credit system as against the target of 5 million. For 2007-08, the Union Finance Minister has fixed a target of Rs.2,25,000 crore for disbursement by banks while adding another five million farmers to their portfolio.

III.71 Reflecting the various policy initiatives, the share of outstanding agricultural advances of public sector banks in net bank credit has shown a steady increase over the past few years (Table 3.10).

III.72 The recovery of direct agricultural advances of public sector banks has also exhibited an improvement in recent years (Table 3.11).

Micro-finance

III.73 Of the different models for delivery of micro-finance, the SHG-Bank Linkage Programme has emerged as the major micro-finance programme in

Table 3.10: Outstanding Agricultural Advances

(Amount in Rupees crore)

As at end-March	Public Sector Banks		Private Sector Banks	
	Amount Outstanding	Per cent of Net Bank Credit	Amount Outstanding	Per cent of Net Bank Credit
1	2	3	4	5
2003	70,501	14.5	9,924	10.9
2004	84,435	15.1	14,730	12.7
2005	1,09,917	15.3	21,636	12.3
2006	1,55,220	15.3	36,712	13.6
2007*	2,05,091	15.6	52,056	12.8

* : Provisional.

Table 3.11: Public Sector Banks – Recovery of Direct Agricultural Advances

(Rupees crore)

Year ended June	Demand	Recovery	Overdue	Percentage of Recovery to demand
1	2	3	4	5
2003	28,940	21,011	7,930	72.6
2004	33,544	25,002	8,542	74.5
2005	45,454	35,733	9,721	78.6
2006	46,567	37,298	9,269	80.1

the country (Table 3.12). As at end-March 2007, 2.9 million SHGs were linked to banks covering a total flow of credit of Rs.18,040 crore. Based on the findings of a joint study conducted by the Reserve Bank along with a few major banks, the banks were advised in November 2006 to encourage micro-finance institutions (MFIs) assisted by them to (i) focus on unbanked and underbanked areas; (ii) desist from multiple lending; (iii) engage in capacity building and empowerment of the groups; and (iv) follow practices that maintain the cohesiveness of the groups. In order to ascertain the degree of transparency in maintaining the accounts by the SHGs and their adherence to well-accepted best practices, the Reserve Bank will conduct an evaluation of the Bank-SHG Linkage Programme through its regional offices.

Kisan Credit Cards

III.74 The Kisan Credit Card (KCC) scheme was introduced in 1998-99 to provide adequate and timely credit support to the farmers from the banking system in a flexible, hassle-free and cost-effective manner. During 2006-2007, the public sector banks issued 4.8 million KCCs covering limits aggregating Rs.26,215 crore. Since the inception of the scheme, 26.6 million KCCs have been issued by the public sector banks, with limits amounting to Rs.94,712 crore.

Table 3.12: Progress of SHG-Bank Linkage Programme

Year	Total SHGs financed by Banks (Nos. '000)		Bank Loans (Rupees crore)	
	During the year	Cumulative	During the year	Cumulative
1	2	3	4	5
1992-99	33	33	57	57
1999-00	82	115	136	193
2000-01	149	264	288	481
2001-02	198	461	545	1,026
2002-03	256	717	1,022	2,049
2003-04	362	1079	1,856	3,904
2004-05	539	1618	2,994	6,898
2005-06	620	2239	4,499	11,398
2006-07	686	2924	6,643	18,040

Source : NABARD.

Rural Infrastructure Development Fund (RIDF)

III.75 Domestic scheduled commercial banks, both in the public and private sectors, which are unable to meet their targets for priority sector/agricultural lending, are required to deposit the shortfall amount into the Rural Infrastructure Development Fund (RIDF) with NABARD such amounts as may be allocated to them by the Reserve Bank, depending upon the extent of their shortfall. The rates of interest on these deposits are inversely proportional to the extent of deficit in achieving the agricultural lending target. The Fund has completed 12 years of operation. In terms of the announcement made by the Union Finance Minister in his budget speech for the year 2007-08, RIDF XIII has been set up with NABARD with a corpus of Rs.12,000 crore during 2007-08. The separate window opened under the RIDF XII for financing of rural roads under *Bharat Nirman* with a corpus of Rs.4,000 crore during 2006-07 has been continued, as announced in the Union Finance Minister's budget speech for the year 2007-08, with an additional corpus of Rs.4,000 crore. Out of the total corpus of the RIDF (RIDF I to RIDF XII) of Rs.60,000 crore, cumulative sanctions and disbursements under various tranches amounted to Rs.61,312 crore and Rs.38,934 crore, respectively, as on July 31, 2007.

Deposits by Foreign Banks with Small Industries Bank of India (SIDBI)

III.76 Foreign banks operating in India, which do not meet the target/sub-targets under the priority sector lending, are required to deposit amounts equivalent to the shortfall with the Small Industries Development Bank of India (SIDBI) for a period of three years. The interest rates on such deposits have been linked inversely to the extent of shortfall in the overall target (32 per cent of net bank credit) or aggregate shortfall in sub-targets for SSI (10 per cent) and export credit (12 per cent), whichever is higher. Aggregate amounts of Rs.1,058 crore and Rs.1,031 crore were deposited by the foreign banks with SIDBI on the basis of shortfall in their priority sector lending as on the last reporting Fridays of March 2006 and March 2007, respectively.

III.77 In terms of revised priority sector guidelines, the foreign banks not meeting the priority sector target/sub-targets will be required to contribute the shortfall to the Small Enterprises Development Fund (SEDF) to be set up with the SIDBI, or for such other purpose as may be stipulated by the Reserve Bank from time to time. For the purpose of such allocation, the achievement level of the priority sector lending as on the last reporting Friday of March of the immediately preceding financial year would be taken into account. The corpus of the SEDF would be decided by the Reserve Bank on a year-to-year basis. The tenor of the deposits shall be for a period of three years or as decided by the Reserve Bank from time to time. Fifty per cent of the corpus shall be contributed by the foreign banks having shortfall in lending to the priority sector target of 32 per cent of the adjusted net bank credit (ANBC) or credit equivalent amount of the off-balance sheet exposure, whichever is higher, on a *pro rata* basis. The balance 50 per cent of the corpus shall be contributed by the foreign banks having aggregate shortfall in lending to the small enterprises and export sectors of 10 per cent and 12 per cent, respectively, of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher, on a *pro rata* basis.

Credit to Women

III.78 Public sector banks (PSBs) are required to lend at least 5 per cent of their net bank credit to women. The credit extended to women by all PSBs was 4.95 per cent of the overall net bank credit at end-March 2007, with 21 PSBs reaching the target. Eight PSBs have opened 15 specialised women branches.

Credit to Small and Medium Enterprises

III.79 The total credit provided by the PSBs to the SSI sector as on the last reporting Friday of March 2007 was Rs.1,04,703 crore, constituting 8.0 per cent of their net bank credit and 20.1 per cent of their total priority sector advances. Advances to cottage industries, artisans and tiny industries amounted to Rs.44,311 crore, constituting 42.3 per cent of the advances to the SSI sector. PSBs are required to operationalise at least one specialised SSI branch in every district and centre having cluster of SSI units. At end-March 2007, the PSBs had operationalised 636 specialised SSI bank branches.

III.80 The credit flow from the PSBs to medium enterprises is being monitored by the Reserve Bank on a quarterly basis with effect from March 2006. Outstanding credit from PSBs to medium enterprises increased from Rs 61,462 crore at end-March 2006 to Rs.74,238 crore at end-March 2007.

Sick SSI units

III.81 Based on the recommendations of the Kohli Working Group, the Reserve Bank had issued detailed revised guidelines to banks in January 2002 for detection of sickness at an early stage and taking remedial measures for rehabilitation of sick SSI units identified as potentially viable. As per the revised guidelines, the rehabilitation package needs to be fully implemented within six months from the date the unit is declared as viable/potentially viable. The total number of sick SSI units and the amount of credit outstanding against them in the books of scheduled commercial banks at end-March 2006 declined in comparison with end-March 2005 (Table 3.13).

Micro, Small and Medium Enterprises Development (MSMED) Act, 2006

III.82 The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 came into effect from October 2, 2006. The Act classifies enterprises broadly into (i) manufacture/production of goods and (ii) providing/rendering of services. These are further classified into micro enterprises, small enterprises

Table 3.13 : Credit to Sick SSI Units

(Amount in Rupees crore)

End-March	Total Number of Sick Units		Potentially Viable		Non-Viable		Viability yet to be Decided		Units put under Nursing	
	Units	Amount	Units	Amount	Units	Amount	Units	Amount	Units	Amount
1	2	3	4	5	6	7	8	9	10	11
2004	143366	5773	2406	551	138081	4937	2938	266	729	281
2005	138041	5380	3922	435	132153	4884	1966	61	2080	260
2006	126824	4981	4594	498	117148	4141	5082	342	915	234

and medium enterprises, depending upon the level of investment in plant and machinery and equipment, respectively. The definition of small and medium enterprises as defined in the Act has been incorporated into the revised priority sector guidelines issued on April 30, 2007.

Government Sponsored Schemes

III.83 Under the *Swarnjayanti Gram Swarozgar Yojana* (SGSY), during the year 2006-07, a total number of 12,36,511 *swarozgaris (*self-employed*)* received bank credit amounting to Rs.1141.2 crore (and Government subsidy amounting to Rs.367 crore). Of the *Swarozgaris* assisted, 27.7 per cent belonged to the scheduled castes and scheduled tribes (SC/ST), 48.8 per cent were women and 1.3 per cent were physically handicapped. Under the *Swarna Jayanti Shahari Rozgar Yojana* (SJSRY), Rs.198.5 crore was disbursed in 58,389 cases (out of 1,23,211 applications sanctioned) during 2006-07; the beneficiaries included 14,324 SC/STs, 12,842 women and 643 disabled persons with amounts disbursed aggregating Rs.44.8 crore, Rs.41.4 crore and Rs.2.5 crore, respectively. Under the Scheme for Liberation and Rehabilitation of Scavengers (SLRS), disbursements to 6,805 beneficiaries aggregated Rs.16.4 crore; category-wise, loans disbursed to 6,229 SC/STs, 2,168 women and 316 OBCs, amounted to Rs.15 crore, Rs.4.7 crore and Rs.0.6 crore, respectively during the year 2006-07. Assistance under the Prime Minister's *Rozgar Yojana* (PMRY) scheme as on March 2007 amounted to Rs.1,405 crore for 2,31,524 beneficiaries during 2006-07.

Differential Rate of Interest (DRI) Scheme

III.84 The outstanding advances of PSBs under the DRI Scheme as on the last reporting Friday of March 2007 at Rs.634 crore (around 0.3 million accounts), constituted 0.1 per cent of the total outstanding advances at the end of the previous year (as against the target of 1.0 per cent). As announced by the Union Finance Minister in his budget speech for the year 2007-08, the limit of the loans under the DRI Scheme has been raised from Rs.6,500 to Rs.15,000 and that of the housing loans under the Scheme from Rs.5,000 to Rs.20,000 per beneficiary.