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Monetary and Credit Policy for Second half of 1997-98

Measures

Dr. C. Rangarajan, Governor, Reserve Bank of India today announced the Monetary and Credit Policy for the second-half of 1997-98. He was addressing the chief executives of leading scheduled commercial banks in Mumbai. While the measures have been summarised in the enclosed table, some highlights of the measures include:

- Bank Rate reduced by one percentage point to 9 per cent
- CRR reduced by two percentage points and SLR made uniform at 25 per cent.
- Interest rates on domestic term deposits deregulated.
- Banks to prescribe a separate prime term lending rate.
- Interest rate on pre-shipment rupee export credit reduced by one percentage point.
- Bridge loans against equity issues/flows permitted.
- Improvements in credit delivery for sugar, small scale industries, trade, transport, services and housing.
- Ready forward in PSU bonds and debt securities permitted.
- Measures for further development of money and government securities market.

Stance of Monetary and Credit Policy

Continues to seek to attend the twin-objective of promoting price stability and ensuring availability of adequate bank credit for productive sectors.

Rationale and approach

Explaining the rationale of the policy, Governor Rangarajan stated that the measures enunciated today, essentially reflect a multi-pronged approach to monetary management. The carry forward the reforms that were initiated in April 1997 and facilitate the use of macro-economic and structural measures to deepen as well as to bring about integration of the financial markets. This is necessary to achieve financial stability and allocative efficiency, he added.

Governor stated that the need to keep the overall monetary growth within the targeted range stems from the objective of maintaining a reasonable degree of price stability which by itself is of critical importance in ensuring domestic stability and international competitiveness.

The thrust of the policy, Governor explained, has been on reduction of direct methods of control and to use interest rates as signals to bring about efficient functioning of the financial system.

Dr. Rangarajan explained that the measures announced today aim at expanding the lendable resources of banks and reducing the cost of funds without impairing the profitability of banks. The deregulation of interest rates and the reduction of cash reserve ratio would give enough degrees of freedom to banks in the management of their portfolios in optimising profits and productivity. Governor stressed that the gains arising out of these measures would need to be shared with borrowers.

Pointing out that the interest rates have come down sharply during the year so far and that the inflation rate has also dropped significantly, Governor stressed that banks on their part would also have to make concerted efforts to reduce spreads and pass on some of the efficiency gains in the form of lower interest rates to the borrowers.

In a special exhortation to the bankers, the Governor stated that while credit for production is necessary, it is equally important to ensure that the distribution channels, that is trade and the services sector get the required credit. In this context, Governor asked the banks to have the arrangements for finance reviewed by their boards with a view to enhancing the resources flowing to trade and to devise alternative methods of assessing the loan requirements of the services sector. He also requested banks to evolve suitable schemes which will result in the increased availability of credit to these sectors. Two other sectors which need special mention are housing and auto finance, particularly for trucks, Governor added and said that expansion in both these sectors is likely to have large multiplier effects.

With a view to ensuring prompt settlement of dues of SSI units as also to encouraging bills' culture, Governor also advised banks to ensure that with effect from January 1, 1998 banks extend not less than 25 per cent of the total inland credit purchases of their borrowers through bills drawn on banks by concerned sellers.

Dr. Rangarajan, desired that bank boards should lay down the loan policies in clear-cut terms in respect of different categories of borrowers - small, medium and large.

In conclusion, the Governor cautioned bankers that with progressive liberalisation of the financial markets, comprehensive risk management was essential. The recent events in the international scene have demonstrated the criticality of the soundness of the financial system for maintaining macro-economic stability and for ensuring sustained growth. In this context, it is imperative that banks, being the vital component of the financial system, should equip themselves to meet the challenges of the second phase of the financial sector reforms which will compel banks to operate in a more competitive environment. The response should be in terms of improved organisational effectiveness and better risk management.

Background

- Perceptible deceleration in inflation rates.
- Sharp downward movement in interest rates, both short-term and long-term.
- Government's market borrowing programme nearly complete.
- Stable foreign exchange market.
- Though industrial production in the first four months of 1997-98 was sluggish, demand expected to augment and result in improved consumption, investment and exports.
- M_3 around projected trajectory of 15-15.5 per cent.
- Strong growth in aggregate deposits.
- Non-food credit shows a pick-up in recent period
- Strong growth in bank investments in corporate paper.
- Capital market somewhat sluggish.

(Alpana Killawala)
General Manager