CHAPTER - VI

BANKING TREND OF ALLAHABD BANK IN BANDE ECONOMY

6.1 A Brief History of Banking
6.2 Origin of Lead Bank - Allahabad Bank
6.3 Functions of Lead Bank
6.4 Expansion of Branches of Commercial Banks
   6.4.1 Branch Licensing Policy
6.5 Present Status of Allahabad Bank
6.6 Monetary and Credit Policy
   6.6.1 Stance of Monetary and Credit Policy for 2002-03
   6.6.2 Monetary Measures
   6.6.3 Credit Delivery Mechanism
6.7 Supervision and Monitoring
CHAPTER - VI

BANKING TREND OF ALLAHABAD BANK IN BANDA ECONOMY

6.1 A BRIEF HISTORY OF BANKING:

"Long years ago we made a tryst with destiny, and now the time comes when we shall redeem our pledge, not wholly or in full measure, but very substantially. At the stroke of the midnight hour, when the world sleeps India will awake to life and freedom. The achievement we celebrate today is but a step, an opening of opportunity, to the greater triumphs and achievements that awaits us. Are we brave enough and wise enough to grasp this opportunity and accept the challenge of the future?"

As Nehru proclaimed the birth of a free nation with these prophetic words, little before midnight of the 14th August 1947 - a new era began in the history of banking in India.

Although banking in India was as old as her civilization, it was the British rulers who introduced modern banking in the country. Introduction of banking in the country helps in conducting transaction in money otherwise, people were using something other things in lieu of money, what is called barter economy. An incomplete list of things that have served as money are clay, goats, rice, iron, copper, hoes, stone, debts of the banks, cattle etc.

Bank of Bengal was established in 1809 followed by other presidency banks viz Bank of Bombay and Bank of Madras in 1840 and 1843 respectively. Immediately after independence, Reserve Bank of India, which started functioning in 1935 as a shareholders' bank was nationalised in
1948 and thereafter, the Banking Regulation Act was enacted in 1949. In 1955 the Imperial Bank of India which was formed by amalgamation of the presidency banks, was taken over by the government and was rechristened as State Bank of India.

From the very beginning, Indian policy makers embraced socialistic pattern of society with the objective of reducing inequalities in income and wealth. It was observed that the operations of the Banking system was not conducive to realisation of this goal. Banks were controlled by big industrialists, who cornered the major share of bank funds at the cost of the weaker sections demanding priority.

In order to impose social control over banks the Government set up National Credit Council in 1967 for determining priority in lending and amendment the Banking Regulation Act to tighten legislative Control.

The idea was somewhat akin to the Gandhian concept of trusteeship. Gandhiji believed that any asset physical, intellectual or otherwise which is held by anybody is held as a trustee for the benefit of the society at large.

However, social control failed to achieve its desired objective because “the weakness of social control was that in many banks people who had been controlling their policies in the past continued to exercise their influence.” Therefore, it was decided that direct control would be more effective. "In order to serve better, the needs of development of the economy in conformity with the national policy objectives 14 major banks were nationalised in 1969. And finally, in 1980, the process was completed with the nationalisation of six more banks. Any amount of statistical data
can be furnished to substantiate the achievements of nationalisation, but nothing can put it more emphatically than the following words of Sri B.K. Ghose, Ex. CMD of Dena Bank:

"The post nationalisation period has witnessed a complete re-organisation of Indian Banking from "Class" banking to "Mass" banking. There has, in fact, been a change in the very concept, percept and outlook of Banking."

But the achievement did not come without a price. PSU banks had to pay dearly for their plunge into social banking in terms of low productivity, increase in Non Performing Assets, rising costs, inefficiencies in operation and growing number of loss making branches. There were complaints of deterioration in customer service. The Banks failed to make full use of advancement in communication and banking technology.

A major portion of their funds were pre-empted by Govt. through high percentage of SLR/CRR and for providing credit support to the weaker sections at concessional rate of interest. Consequently, profitability took a beating. Their woes were aggravated by the securities scam.

6.2 ORIGIN OF LEAD BANK: ALLAHABAD BANK

Allahabad Bank, the oldest joint stock bank of the country was setup in the historic town of Allahabad on April 24, 1865 by a group of Europeans. At that juncture, in India, organised industry, trade and banking had just started taking place.

The bank was started with a subscribed capital of Rs. 2.00 lacs and by the end of 19th century, it had branches at Jhansi, Kanpur, Lucknow,
Bareilly, Nainital, Kolkata and Delhi. In the early 20th century, with the start of Swadeshi Movement, Allahabad Bank witnessed a spurt in deposits and reserves increased to over Rs. 30 lacs by 1910.

In 1920, the bank was taken over by P&O Banking Corporation at a bid price of Rs. 436 per share. The Head Office and the Registered Office of the Bank were then shifted to Kolkata in 1923 for business considerations and operational convenience. In 1927, the banks went into the fold of Chartered Bank, that acquired the controlling interest in the P&O Banking Corporation.

The Bank passed through the critical period of ‘Great Depression’ during the early thirties, which caused a general stagnation in the global markets, without sparing the Indian Banking Industry. The Bank dovetailed its functioning, in accordance with the exigencies of the Five Year Plans, which were started in 1951. In the post independence era, Allahabad Bank maintained a steady growth and by 1964, the bank had opened its 100th branch. On July 19, 1969, along with 13 other major commercial banks, Allahabad Bank was nationalised. At the time of nationalisation, the Bank had a network of 151 branches, deposits of Rs. 114 crores and advances of Rs. 82 crores to its credit, with nationalisation, the bank spread its activities in the rural, unbanked and underbanked areas. At the end of 1979, the branch network of the Bank increased to 875 with the share of rural branches being 46.40 percent. Deposits of the bank grew to Rs. 735 crores at the end of 1979 while advances rose to Rs. 407 crores. In order to bolster the rural economy, a plethora of Social Banking Schemes was introduced. Thus, Lead Bank Scheme (1969), Regional Rural
Banks (1975). Twenty Point Programme (1975), New twenty point programme (1981). Integrated Rural Development Programme (1980) etc. were introduced in the Indian Banking industry. Directed lending to priority sectors, weaker sections. Scheduled castes, Scheduled Tribes and other Backward castes were given a greater thrust and the Bank responded to this initiative and increased its presence in these areas also. As on March 31, 2002, the Bank’s priority sector credit is at Rs. 4885 crores, forming 44.40 percent of net credit and agriculture credit is over Rs. 1994 crores constituting 18.10 percent of net credit.

The Bank opened its 1000 branch on April 3, 1982. The bank had also started opening specialised branches. SSI Finance Branches, Recovery Branches etc.

The bank made a foray into merchant banking activities in 1984 and subsequently transferred the merchant banking activities to All Bank Finance Limited, a wholly own subsidiary in 1991. All Bank Finance Ltd. was registered as a category I Merchant Banker with SEBI and undertook activities such as project advisory services, loan syndication, issue management, leasing, trusteeship and portfolio investment services. Consequent upon the SEBI Rules and Regulations notified on Dec. 9, 1997 for segregation of capital market and fund based activities into separate entities, the company surrendered its merchant banking registration with SEBI with effect from July 1, 1998 and got itself registered as NBFC with RBI on August 21, 1998. In October 1989, United Industrial Bank Ltd. was amalgamated into Allahabad Bank. The Bank ventured into the credit card business by launching its credit card the BOBCARD, Allahabad
Bank, with Bank of Baroda on April 25, 1989. The Bank, in 1992-93, entered into a memorandum of understanding with Bank of India to launch Indiacard, replacing BOBCARD. Indiacard has got affiliation with Master Card International.

One of the major challenges faced by the bank was the accumulated losses incurred by it for three consecutive years i.e. from 1992-93 to 1994-95, owing to the adoption of prudential accounting norms, in line with RBI directives. To overcome this situation and to strengthen the bank in various functional areas, a major revamping exercise was initiated. The bank put a greater thrust on areas like technological upgradation and modernisation, improvement in customer services, credit management with focus to reduce non-performing assets etc. The Bank staged a turnaround in 1995-96 with a net profit of Rs. 5.62 crores which increased to Rs. 129.21 crores in 1997-98 and then to Rs. 135 crores in 1998-99.

It has launched "Gold Trading" with the approval of Reserve Bank of India for import of gold under open general license. The Bank become the first nationalised bank in Eastern India to become depository participant of National Securities Depository Ltd. to offer and related services and initiated "Flexi Fix Deposit Scheme" to mobilise resources. The Bank also introduced "Kisan Card" to facilitate agriculture related activities as well as to meet the domestic requirements of farmers. In order to boost credit off take, the Bank has launched user friendly and attractive products viz consumer finance, car finance, educational loans etc.

The growth of the Bank over the years is in the table below:
### Table 6.1

**Growth of Banks**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Branches</th>
<th>Paid up Capital</th>
<th>Deposits</th>
<th>Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>1865</td>
<td>1</td>
<td>0.02</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>1890</td>
<td>4</td>
<td>0.04</td>
<td>0.70</td>
<td>0.53</td>
</tr>
<tr>
<td>1910</td>
<td>15</td>
<td>0.20</td>
<td>5.53</td>
<td>4.66</td>
</tr>
<tr>
<td>1930</td>
<td>37</td>
<td>0.36</td>
<td>11.36</td>
<td>5.21</td>
</tr>
<tr>
<td>1950</td>
<td>58</td>
<td>0.46</td>
<td>27.16</td>
<td>14.97</td>
</tr>
<tr>
<td>1970</td>
<td>211</td>
<td>1.05</td>
<td>140.70</td>
<td>95.95</td>
</tr>
<tr>
<td>1989</td>
<td>1509</td>
<td>57.50</td>
<td>4034.04</td>
<td>1831.77</td>
</tr>
<tr>
<td>1999</td>
<td>1884</td>
<td>246.70</td>
<td>15510.35</td>
<td>7057.07</td>
</tr>
<tr>
<td>2000</td>
<td>1893</td>
<td>246.70</td>
<td>17642.10</td>
<td>8240.06</td>
</tr>
<tr>
<td>2001</td>
<td>1903</td>
<td>246.10</td>
<td>20106.02</td>
<td>10315.80</td>
</tr>
<tr>
<td>2002</td>
<td>1914</td>
<td>246.70</td>
<td>22665.94</td>
<td>11815.01</td>
</tr>
</tbody>
</table>

Source: Allahabad Bank Offer Document 2002-03.

**Advantages Expected from Lead Bank:**

The close involvement of the lead bank with a particular area will not only result in deposit mobilisation but also in the expansion of finance to agriculture and small industries. Individual Lead Bank was expected to make a detailed survey of the area of their operation and the potential in that area for economic growth and evolve schemes to accelerate their involvement in their respective areas.
The following important advantages were expected from the lead Bank Scheme:

1. The whole country would be served by a well-knit system of the commercial cooperative banking.
2. Branch expansion, supervision and guidance would become effective.
3. A dynamic relationship between commercial banks, cooperative credit institutions and government authorities as the district level would evolve.
4. That would be a close integration of credit and banking business with other activities.

The main advantages of the Lead Bank can be better appreciated against the background of the miseries met by millions of plough men in India even after attainment of freedom. Some social security measures in rudimentary forms were there, no doubt, but they were not all embracing that “banker must become the friend, philosopher, guide of the farmer by providing technical assistance, inputs, supervision of credit and input use, and by simultaneously financing the development of storage and marketing facilities”⁴. (P.M. Indira Gandhi, 1969)

6.3 FUNCTIONS OF LEAD BANK:

Commercial Banks were given district as their units of development far away from their principal areas of their operation. The lead bank survey and identify bankable schemes serves as a clearing house through district level consultative committee for discussion problems arising out of financing of priority sectors.
The main functions of bank are listed below:

1. Survey of banking potential.

2. To identify places, suitable for branch expansion, deposit mobilisation and credit expansion.

3. Prepared a phased programme for branch expansion in the district so as to bring banking services within the ambit of the entire area.

4. Estimate the current needs of credit and prepare a phased programme to meet it by supplanting the non institutional (money lender type) purveyors of credit.

5. Identify the potential area of agricultural and small industry development and to encourage local entrepreneur in agriculture and small industry to improve progressively his productive efficiency.

6. To devise such schemes of deposits and financial investment, as would prove attractive and effective to the local people for mobilising deposits as well as raising the rates of saving in the district and;

7. To reduce, if not completely remove, the regional and functional imbalances in banking development.

8. To ensure proper coordination in the implementation of special schemes such as IRDP, TRYSEM, for SSS in tiny sector.

9. To formulate special schemes for beneficiaries to be covered under the 20 point economic programme in consultation with the state government agencies.

10. Arising other primary lending agencies.

11. Follow up and inspection of the end use of loans.
Thus, the lead bank is a financial house for credit and deposit mobilisation, planning agency for the district, a development bank and co-ordination of planning and implementation forum. In a way, it is more or less central bank and a credit planning and implementing agency of the districts.

6.4 EXPANSION OF BRANCHES OF COMMERCIAL BANKS:

Nationalisation in major commercial banks in 1969 has witnessed unprecedented growth in the branch network of banks. This phenomenal increase in the branches of banks have also result into multifarious activities of banks. In a period of about three years, banks have made their efforts in reducing disparities in regional spread of banking facilities. Branches of banks have also opened in a very remote area, rural semi-urban areas. The national average of population per banking offices has been brought down substantially and the divergence between the national average and the average in certain regions has been narrowed. The ‘Lead Bank Scheme’ which is oriented toward as ‘area approach’ for banking development in the country has setup the pace for branch expansion in a co-oriented way.

The nationalisation has imparted a new sense of urgency to the problem of expanding the geographical coverage of the banking system with a view to providing banking facilities to the underdeveloped areas expeditiously. The study group of the National Credit Council on ‘organised framework of or the implementation of social objectives’ under the chairmanship of Prof. D.R. Gadgil, observes in October 1969 that banking
credit was unevenly distributed as between different states and as between different sectors. It further revealed that credit extended by the banks was not widely dispersed and there were credit gaps, particularly in the case of a small borrowers. The groups recommended the operation of an ‘area approach’ to evolve plans and programmes. In this context, it was felt that a close involvement of a bank with a particular area would not only expand its efforts towards deposit mobilisation but also enlarge its sphere of finance to agriculture, small industry and other priority sectors.

The Reserve Bank of India has been arranging regionwise meetings of the representatives of all the lead banks. So far, seven such meetings have been convened at Madras, Kanpur, Patna, New Delhi, Calcutta, Bhopal and Jaipur and 833 unbanked centres allotted to various banks. Banks have also been convening similar meetings at district level for allocation of unbanked centres identified in the local survey. It would be of interest to note that of 5375 offices opened since nationalisation i.e. from 19th July 1969 to end June 1972, as many as 3416 or 63.5 percent were opened in hitherto unbanked centres. The relatively under developed states of Assam, Bihar, Jammu & Kashmir, Madhya Pradesh, Manipur, Meghalaya, Nagaland, Orissa, Rajasthan, Tripura, Uttar Pradesh and West Bengal accounted for 31.6 percent of these new offices. Even out of the offices opened at unbanked centre, these states accounted for 34.1 percent. In Manipur and the Union Territories of Arunachal Pradesh, Dadar and Nagar Haveli and Mizoram, all the offices opened during July 1971-June 1972 were at unbanked centres. Under perspective planning commercial banks
would be able to open at least about 1500 branches each in 1972 and 1973 and perhaps somewhat more in 1974, adding up to a total of about 5000 branches. Banks have been advised to be more selective in the matter of further branch expansion and take into account the objective of providing banking facilities in centre with potential, their responsibility in their lead districts, their areas of operation and the need for giving priority to the relatively under developed/under banked states. In addition banks have been advised to constantly appraise the performance of their branches in relation to their present business and future goals. For the long time it was felt that there was a gap in the distribution of bank offices in the district as a result masses were not getting benefit of the banking service. The district wise spread of bank offices was taken and lead bank schemes. The district wise spread of bank offices reveals that the imbalances in the availability of banking services as between different districts has been corrected to a large extent. The average population per bank offices was 65000 at the end of June 1969 and 12000 at the end of June 1989 and March 1990. The percentage of bank offices in rural areas increase from 22 percent in 1989 to 57.0 percent at the end of June 1989. In, there was 325 villages to a rural branch. In 1983 this ratio declined to 27 to 1 and now it is 15 to 1. In June, 1990 there was lead organisation of some lead districts, in which case more districts were carved out of the some of the existing ones.

6.4.1 BRANCH LICENSING POLICY:

In the recent period, the policy for commercial banks has been
substantially liberalised, Bank’s Board have been empowered to decide on the policy and strategy for setting up of new branches, closing and shifting of existing branches, subject to certain conditions. In order to encourage more efficient banking services all over the country, it is proposed to provide further flexibility in the branch licensing policy.

RBI will consider favourably any proposal for transfer of branches in rural and semi urban centres from one commercial banks to another by mutual agreement banks will be expected to ensure that such mutually agreed transfers do not adversely affect the available banking services in area.

6.5 PRESENT STATUS OF ALLAHABAD BANK:

As on March 31, 2002, the bank had 1914 branches, comprising 959 rural, 321 semiurban, 367 urban and 267 metropolitan, which formed 50.1 percent, 16.8 percent, 19.1 percent and 14.0 percent of the total respectively. The branches include 32 specialised branches (i.e. 4 industrial finance branches, 6 SSI Finance Branches, 6 International Branches, 6 Recovery Branches, 1 NRI Branch, 1 Industrial Finance cum International Branch, 2 Specialised Personal Banking Branch, 1 Specialised Savings Bank Branch, Quick Collection Services Branch and 2 Trading Finance Branch) besides 16 services branches. The Bank has 138 Extension Counters. A number of Bank’s branches and offices are housed in the Bank’s owned premises situated at prime locations in major cities of the country.

The Bank has been fulfilling its responsibilities under the Service Area Approach. The Bank has sponsored 7 Gramin Banks (RRBs) (6 in
U.P. and 1 in M.P.) and has Lead Bank responsibilities in 15 districts (13 in U.P. and one each in M.P. and West Bengal).

The bank has been entrusted with SLBC convenorship in the newly formed state of Jharkhand. The Bank is continuing its endeavour for economic upliftment of the state through its various development programmes. The Bank has set up a residential institute in the home of Birsha Munda Institute of Entrepreneurship Development at Hazaribagh as a part of promotional measures for enhancement of flow of bank credit in Jharkhand State. The Institute has so far imparted training to 281 entrepreneurs, a majority of who are women, to take up various economic activities.

The bank’s performance was noticeable in implementation of ‘Kisan Credit Card’ launched on 1.9.1998 to ensure easy and timely supply of credit to farmers for their short term working capital requirements for agricultural activities and also for domestic requirements e.g. education, consumable items, medical expenses etc. of its existing clients. The Bank received third prize for exceeding the disbursement target in 2000-01. During 2001-02, the Bank issued 1,11,871 cards as against the target of 76000. With the ‘Kisan Credit Card’ a new feature of Group Personal Accident Insurance cover has been provided.

The Bank has been giving much importance to Human Resource Development. It has sent some officers for overseas training also. Computerisation and automation of operations continued to receive focussed attention from the Bank. The Bank has 333 partial and 342 totally mechanised branches and 40 ATMs.
The Bank launched Telebanking in 3 branches and internet banking in 5 branches during this year. The Bank has also installed its own VSAT based Intranet and website. The Bank has computerised 72.3 percent of its business as at March end 2002.

6.6 MONETARY AND CREDIT POLICY:

The basic objective of monetary policy in a developing country like India is to promote economic growth in an environment of reasonable price stability. Further, in an economy characterised by wide disparities, an important objective is that growth should be accompanied by distributive justice. If all these objectives were so related that the pursuit of one automatically led to the fulfillment of the others, the formulation and implementation of monetary policy would have been indeed easy tasks. In reality there is a good deal of incompatibility and some trade offs, as between these objectives become inevitable.

The monetary and credit policy 2002-03 has the best blend of measures to speed up the second generation reforms manifesting a commitment to tow the banks towards global best practices, Reserve Bank of India has been administering the measures of reforms aligning them to the capacity of Banks to endure. The process of deregulation, regulations and re-regulations are planned to infuse more to the Banks to withstand the influence of various forms of risks. RBI made a significant mention of its commitment to improve the capacity of banks to implement the new capital account evolved by the Bank for International Settlement, more particularly to manage their market risks. The nuances of these
market risks in a liberalizing environment have the potentiality to erode the net worth of money banks if not properly and proactively supervised. The short term stance of the Monetary Credit Policy to be to me liquidity requirements for sustained credit growth and to maintain buoyancy for demand for investment in the economy. The medium term shall focus on greater flexibility in the interest rate structure. However, both these aspects continue to be the on-going objectives of monetary policy to increase, the efficacy of transfer mechanism and enhance financial stability.

It can further be observed that the long-term objectives are candidly intended to implant sound principles of prudential banking structure built on strong and sustainable fundamentals. These are met by gradually implementing the measures of banking sector reforms suggested by Narsimhan Committee II.

6.6.1 STANCE OF MONETARY AND CREDIT POLICY FOR 2002-03:

The overall stance of monetary policy in 2002-03 outlined in annual policy statement of 2002 was as follows:

# Provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level.

# In line with the above, to continue the present stance on interest rates including preference for soft interest rates.

# To impart greater flexibility to the interest rate structure in the medium term.

# To impart greater flexibility to the interest rate structure in the
medium term.

1. In line with its monetary policy stance, liquidity conditions during the year were very comfortable. This is evident from the higher average volume of repo tenders under the liquidity adjustment facility during the year. The average outstanding volume of LAF repo was higher around Rs. 11,300 crore during 2002-03 as compared with Rs. 3500 crore during 2001-02. Though the real GDP growth turned out to be lower than that expected in the annual policy statements of April 2002 because of wide spread drought, the Reserve Bank continued with the policy of emerging adequate liquidity in the financial system for supporting industrial revival noticed during the year.

2. The sharp accretion to foreign currency assets of RBI posed some challenges for liquidity management during the year. During 2002-03, the net foreign currency of RBI (net of revaluation) increased by as much as Rs. 82,090 crore. The monetary impact of such large inflows had to be neutralised by conduct of substantial outright OMO sales. The net outright OMO sales of government securities were Rs. 53780 crore during the year. As a result, the reserve money expansion was Rs. 30,960 crores. Despite the intervention of RBI through sterilisation the interest rate did not firm up as adequate liquidity could be maintained in the system through judicious LAF operations of RBI.

3. Notwithstanding the comfortable liquidity position emanating from the foreign exchange build up, RBI made further progress in meeting
its medium term objective of reduction in the cash reserve ratio. The Cash Reserve Ratio was reduced from 5.5 percent to 5.0 percent in June 2002 and further to 4.75 percent in Nov. 2002 augmenting the lendable resources of banks by about Rs. 10,000 crores.

4. In order to stabilise interest rate expectations, the Reserve Bank of India had signalled its intention, in advance of reducing the Bank Rate by up to half a percentage point (50 basis points) in the annual policy statement of April 2002 if warranted by the evolving liquidity and credit situation. After reviewing the liquidity and monetary conditions the Bank Rate was reduced by 25 basis points to 6.25 percent, and repo-rate under the Liquidity Adjustment Facility was also reduced by 25 basis points to 5.5 percent in the mid-term Review of October 2002. the repo rate under the Liquidity Adjustment Facility was further reduced to 5.0 percent on March 3, 2003.

5. As inflation remained benign for most part of the year, despite the impact of drought and higher oil prices, there was general reduction in market interest rates. The overnight call money rates remained stable and almost overlapped the repo rate. The yield on 91 days and 364 day Treasury Bill and dated government securities of various maturities ruled much lower than yields at the beginning of the financial year. This enabled the large market borrowings programme of the Government to be completed at a low cost without unduly affecting the general interest rate structure. During the last three years (March 2000 - March 2003), the yields on 91
day Treasury Bills, 364 day Treasury Bills and government securities of residual maturity of 10 years have declined substantially from 9.17 percent, 9.93 percent and 10.85 percent in that order to the level of 5.89 percent and 6.21 percent respectively.

6. Despite Drought conditions and volatility in international oil prices, the inflation rate remained benign till Jan 2003 but has picked up since then. The point to point inflation rate in 2002-03 (on March 29, 2003) was significantly higher at 6.2 percent (as compared with 1.6 percent on March 30, 2002).

The recent price increase was however confined to a few commodities essentially mineral oils (because of the Iraq War), and drought related items (oilseeds, edible oils, oil cakes and fibres). Excluding price increase due to such items (with an aggregate weight of 15.4 percent) the inflation rate for the remaining basket works out to 2.7 percent as compared with 1.5 percent last year. Considerable uncertainties still remain on the inflation front due to current geopolitical uncertainties. Further, from the view point of the domestic economy, the progress of the south-west monsoon is important so that supply constrains, which could have an adverse impact on inflation, do not emerge. Movements in international oil prices over the next few months cannot also be predicted as there are uncertainties in the aftermath of the Iraq war. As such, the inflationary situation needs to be watched closely. There is no room for complacency on this account. For the present, however, it is proposed to continue with the policy of maintaining adequate
liquidity in the system and a soft interest rate environment. In case demand pressures emerge and the inflationary situation worsens, which hopefully will not be the case, the present monetary policy stance may have to be reviewed.

7. The monetary policy framework has changed over the recent period in response to reforms in the financial sector. The Reserve Bank's endeavour has been to enhance the allocation efficiency of the financial sector, preserve financial stability and improve the transmission mechanism of monetary policy by moving from direct to indirect instruments. A number of steps have been taken to ensure balanced development of various segments of the financial market as also to preserve its integrity and transparency. The operationalisation of the Clearing Corporation of India Ltd. negotiated dealing system, introduction of collateralised borrowing and lending obligation, prudential limits on uncollateralised call/notice money market and encouragement of collateralised repo transactions, and introduction of interest rate options would increase the depth of the financial market. This process would get a further boost with the operationalisation of the real time gross settlement System.

8. The Reserve Bank is committed to the implementation of the "Core Principles for Effective Banking Supervision" drawn up by the Basel Committee on Banking Supervision. In order to achieve full compliance with these principles, steps have been taken in a phased manner, to move towards a system of consolidated supervision for enhancing the role of external auditors, strengthening corporate
governance, internal controls and audit procedures, increasing transparency and disclosure in the balance sheets of banks. An off site monitoring system was introduced gradually and extended to cover cooperative institutions also.

9. In addition to the initiatives in areas of regulation and supervision, RBI continues to foster institutional structures and mechanisms which would strengthen the existing financial infrastructure. These include setting up of the Credit Information Bureau, introduction of a mechanism for corporate debt restructuring, Non-performing Assets management, technology upgradation and legal aspects. Banks and financial markets have responded well to RBI's regulatory and advisory initiatives. The perceptible improvement recorded by banks is reflected in certain key performance parameters, viz, reduction in net Non-performing Assets ratio and increase in the capital adequacy ratio.

10. The fiscal deficit of the Central Government, which was budgeted at 5.3 percent of GDP for 2002-03, was revised upwards to 5.9 percent. For the year 2003-04, the fiscal deficit is placed at 5.6 percent of GDP and the market borrowing programme of the centre is estimated at Rs. 1,66,230 crore (gross) and Rs. 107194 crore (net). While the market borrowing programme in respect of some states has come under stress, RBI hopes to conduct debt management without serious pressure on overall liquidity and interest rates unless there is a change in the overall macro economics situation due to unanticipated domestic or external
developments.

11. For the purpose of monetary policy formulation, real GDP growth in 2003-04 is placed at about 6.0 percent after taking into account the current trends in the various macro economic factors. Subject to satisfactory spatial distribution if rainfall is around 96 percent of the long term average (as per advance forecast released by India Meteorological Department on April 16, 2003), recovery in agricultural output may be over 3.1 percent during 2003-04 (which is the estimated decline in output during 2002-03). A recovery in agricultural output coupled with the continuance of the upturn in the industrial and the services sectors should help in achieving the projected growth for 2003-04.

12. While assessing the inflationary outlook for 2003-04, the following major developments in the economy will have to be borne in mind:

# The higher base prices at the end of March 2003.
# The expected decline in oil prices (which had picked up during the last quarter of 2002-03)
# Expectation regarding behaviour of the monsoon in 2003-04.

Based on the present assessment of relevant factors, the inflation rate in 2003-04 on a point-to-point basis may be placed in the range of 5.0 to 5.5 percent. As pointed out earlier, the increase in inflation in the last quarter for 2002-03 was dominated by certain commodities such as edible oils, oil cakes and mineral oils. While prices of edible oils increased sharply because of drought, domestic mineral oil prices increased substantially in the wake of the sharp
rise in international oil prices. The prices of these items are, as of now, expected to decline during the course of the year. It is important to initiate measures which through a strong "pass through" effect, will help to soften the prices of commodities which showed would help in further reducing the projected rate of inflation, which would be highly desirable for monetary and financial management.

13. Consistant with the expected GDP growth and inflation, the projected expansion in broad money (M₃) for 2003-04 is placed at 14.0 percent. As the projected expansion of money supply is on a higher base, including the mergers that took place in the banking industry, the volume of liquidity would be adequate to meet the credit needs of the productive sectors of the economy. Consistent with this order of growth in M₃, an increase in aggregate deposits of schedule commercial banks is set at Rs. 1,79,000 crores. Non-food bank credit including investment in commercial paper, shares/debentures/bonds of public sector units and private corporate sector is projected to increase by 15.5-16.0 percent, which should be adequate to facilitate the substance of growth in industrial activity during 2003-04.

14. The Bank Rate Changes, combined with CRR and repo rate changes, have emerged as important tools of liquidity and monetary management. The Liquidity Adjustment Facility has evolved as an effective mechanism for absorbing and/or injecting liquidity on a day to day basis in a more flexible manner and, in the process,
providing a corridor for the call money market. The prudential limits placed on banks and PDs in their operations in the call money market, and gradual phasing out of non-banks from the call money market, are expected to bring integrity to this market, contribute to development of repo/term money market and further help to strengthen the channels of monetary transmission. With most of the procedural and technological upgradation being put in place, RBI’s efforts to make LAF more effective will continue. The RBI will also continue its efforts to bring about development and smooth functioning of the financial markets.

15. An issue of policy interest for financial management by banks and other market participants is whether, after a sharp decline in the past 2-3 years, interest rates have bottomed out. As is well known, the outcome for interest rates depends heavily on the outlook for inflation, growth prospects and investment demand and it is not possible to predict short run movement in interest rates, either up or down, without taking cognizance of possible movement in all the other macro-economic variables. These variables are also subject to unanticipated changes because of unforeseen domestic or external developments.

16. On balance of probabilities, given normal conditions and overall stability in macro-economic environment, in view of several structural constraints, the present nominal and real interest rates are relatively low. There may not be significant potential for further sizeable downward movement in interest rates. Some important structural
factors that contribute to inflation and nominal interest rates in India - which are generally somewhat higher than those in industrial and fast growing emerging market economics are:

(a) the fixation of some food and other procurement prices by the Government which has an important impact on determining the prices of these items, which have a high weightage in price indices.

(b) the need for adjusting several administered food and other subsidies that increase the burden on current expenditure, which contributes to continuing high fiscal deficit, and

(c) the existence of relatively rigid wage structures with built-in inflation related increases in wages, dearness allowances etc. in the organised sector.

17. The above structural factors, which are generally not prevalent in most industrial and emerging market economies, impart an upward bias to sustained price increases from year to year, particularly during the upward phase of the business cycle. It is important to continue efforts over the medium to reduce the impact of these factors inorder to facilitate greater downward flexibility and a sustainable soft interest rate climate.

18. In sum, as per present statement and barring the emergence of any adverse and unexpected developments in the various sectors of the economy, the overall stance of monetary policy for 2003-04 will be :

# Provision of adequate liquidity to meet credit growth and
support investment demand in the economy while continuing a vigil on movement in the price level.

# In line with the above, to continue with the present stance of preference for soft and flexible interest rate environment within the framework of macro economic stability\textsuperscript{10}.

6.6.2 MONETARY MEASURES:

In view of macro-economic and overall monetary conditions and consistent with announcements made by the finance minister regarding certain administered interest rates, RBI reduced the interest rate on serving account from 4.0 percent to 3.5 percent effective from March 1, 2003.

The repo rate under Liquidity Adjustment Facility made available on March 3, 2003 was reduced from 5.5 percent to 5.0 percent and thereafter the cut-off rate is being decided at each auction.

a. **Bank Rate:**

The Bank rate has been reduced by 0.25 percentage point from 6.50 percent with effect from the close of business of October 29, 2002. Commenting on the bank rate reduction, the Governor stated that under the circumstances, as the present and other money market rates were quite comfortable and there was a sizeable gap between these rates and the average lending rates of banks, no useful purpose would be served by a further reduction in the bank rate in the near future. Unless circumstances change, the policy bias in regard to the bank rate is to keep it stable at the present level at least until the end of the financial year.
b. **Repo Rate:**

The repo rate under the LAF of the Reserve Bank of India to be made available from October 30, 2002 has been reduced by 0.25 percentage point\(^1\). Subsequently the auction method for repos will continue as previously. The Governor clarified that while repos auctions are conducted without any pre-announced rate and bids are accepted on the basis of uniform price method, the Reserve Bank has retained the option to switch over to fixed rate repos on overnight basis. The Reserve Bank would continue to use this flexibility of switching over between the options so as to make efficient use of the Liquidity Adjustment Facility system in the daily liquidity management.

c. **Cash Reserve Ratio:**

The Reserve Bank has been pursuing the medium term objective of reducing CRR of banks to the statutory minimum level of 30 percent. In this direction, CRR was gradually reduced from 11.0 percent in August 1998 to 4.75 percent by Nov. 2002. In line with this medium term objective, it is now proposed to:

# To reduce CRR from 5.0 percent to 4.75 percent from the fortnight beginning Nov. 16, 2002. With this CRR has been reduced by as much as 3.75 percentage points over the past two years.

# To raise the minimum daily maintenance of CRR of banks to 80 percent of required amount with effect from the fortnight beginning Nov. 16, 2002. The minimum level of
80 percent would be applicable for all the days in a reporting fortnight.

d. **Interest on cash balances maintained with RBI under CRR:**
In the mid term review of October 2002, in response to a suggestion made by banks, RBI had announced that interest on eligible CRR balances maintained by banks with RBI would be paid on monthly basis, with effect from an appropriate date, as against the present practice of quarterly rests. Accordingly, the first such interest payment will be made for the month of April 2003 covering the fortnights ended April 4, 2003 and April 18, 2003 in the month of May, 2003. Pursuant to this, Reserve Bank of India has suitably modified the interest claim settlement to be submitted by banks.

e. **Statutory Liquidity Ratio of Regional Rural Banks:**

# Statutory Liquidity Ratio holdings of Regional Rural Banks in the form of deposits with sponsor banks maturing beyond March 31, 2003 may be retained till maturity. These deposits may be converted into government securities, an maturity, in case the concerned RRBs, have not achieved the 25 percent minimum level of SLR in government securities by that time.

# Although deposits with sponsor banks contracted before April 30, 2002 would be reckoned for SLR purpose till maturity. RRBs are advised to achieve the target of maintaining 25 percent SLR in government securities out of the maturity proceeds of such deposits with sponsor banks as well as from their incremental public deposits at the earliest.
**Interest Rate Policy:**

a. **Interest Rate Flexibility:**

   The Governor said that the recent monetary policy statements have drawing attention to factors causing rigidities in the structure of interest rates, particularly in the lending rates of commercial banks. There has been some improvement with regard to non-performing assets operating expenses and cost of funds of commercial banks. In order to further improve flexibility, banks have been given freedom to decide the period of reset on variable rate deposits.

b. **Prime Lending Rate of Spread:**

   The governor explained that in the current environment of low inflation, unreasonably wide spreads could adversely affect the overall credit portfolio of banks. Furthermore very wide spreads provide opportunities for non transparency. In order to ensure appropriate pricing of loans, banks are encouraged to review both their prime lending rates and spreads and align spreads within reasonable limits around prime lending rates subject to approval of their Boards.

c. **Interest Rates on Deposits by Cooperative Banks/Regional Rural Banks/Local Area Banks:**

   The governor indicated that interest rates on deposits have been deregulated except deposits in saving bank accounts, which is currently prescribed by the Reserve Bank. However, discretion was given to regional rural banks, local area banks and co-operative banks (urban/central/state to pay additional interest. In order to
remove these anomalies, the governor has suggested:

# Sponsor banks may not pay interest on the current accounts maintained by RRBs with them,
# Co-operative banks may not pay interest on current accounts.
# RRBs/LABs and cooperative banks may not pay any additional interest on the savings bank accounts over and above what is payable by commercial banks.

d. **Interest Rates on Export Credit:**

With view to encouraging competition among banks and also to increase flow of credit to export sector, the governor proposed to liberalise interest rates on rupee export credit in two phases. Accordingly, in the first phase it is proposed that:

# The ceiling rate of PLR plus 0.5 percentage point on pre-shipment credit beyond 180 days and up to 270 days and post shipment credit beyond 90 days and up to 180 days would be deregulated with effect from May, 1, 2003. Banks would have freedom to charge PLR or sub-PLR rates subject to their Board’s approval.

# In the second phase, with effect from a date to be announced later, it would be considered whether the ceiling rates on preshipment credit up to 180 days and postshipment credit up to 90 days should also be discontinued to encourage greater competition in the interest of exports.

e. **Flexibility in the repayment of export credit:**

Repayment/prepayment credit would henceforth be permitted subject
to mutual agreement between the exporter and the banker. For this purpose, balances held in the exporters exchange earners foreign currency account can also be used.

f. **Interest rate on FCNR (B) Deposits:**

The Governor stated that banks are free to decide foreign currency non-resident Banks [FCNR (B)] deposit rates denominated in Japanese Yen which may be equal to or less than LIBOR/swap rates of corresponding maturities till further notice. Interest rate ceiling on FCNR (B) deposits denominated in other currencies would remain unchanged at the prevailing level of LIBOR/swap rates of corresponding maturities minus 25 basis points.

**6.6.3 CREDIT DELIVERY MECHANISM:**

(a) **Priority Sector Lending:**

In order to improve credit delivery to the priority sector, the governor proposed:

# **Agriculture:**

Increase in the limit of advances granted to dealers in drip irrigation/sprinkler irrigation system/agricultural machinery located in rural/semi urban areas from Rs. 10 lakh to Rs. 20 lakh under priority sector lending for agriculture.

# **Small Business:**

Increase in credit limit sanctioned to small business from Rs. 10 lakh to Rs. 20 lakh without any ceiling for working capital. Banks would be free to fix individual limits for working capital depending
upon the requirements of different activities.

# Weaker Sections:

Increase in the individual credit limit to artisans, village and cottage industries from Rs. 25,000 to Rs. 50,000. The limit would be under the overall limit of Rs. 25 percent advances to weaker sections under priority sector or 10 percent of net bank credit.

# Housing Loans:

Increase in the limit of housing loans for repairing damaged houses from Rs. 50000 to Rs. 1 lakh in rural and semi-urban areas and Rs. 2 lakh in urban areas.

b. Micro Finance and Credit:

Micro finance has been defined by RBI as provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standard. Micro credit institutions are those which provide these facilities. Micro credit has been defined as supply of credit to the poor and it is one of the micro finance services.

# Targets:

RBI has not specified any targets to be achieved and has advised banks to devise their own models, prescribed their own criteria for selection of micro credit organisation and lending norms including interest rates. Banks should, however, deal with micro credit organisations having proper credentials, track record, system of maintaining accounts and records with regular audit in place and
manpower for closer supervision and follow-up.

Credit Scheme:

Banks may formulate their own models or choose any conduit, intermediaries for extending micro credit and choose suitable branches, pockets and areas where micro credit programs can be implemented.

Banks can devise appropriate lending and saving products and related terms and conditions such as size of loan, unit cost, unit size, maturity period, grace period etc., keeping in view the ground realities. Credit should however cover their production, consumption and housing shelter requirements.

Banks are to include micro credit in their branch credit plans, block credit plan, district credit plan and state credit plan. Micro credit is to form an intergral part of bank's corporate credit plan and which is to be reviewed at the highest level on a quarterly basis.

Table of the micro financing by commercialised banks has been given in Table 6.2. Here primary sector, SSI (Other) IRDP, Village industries and rural artisans are assumed as a micro unit. Micro financing for priority sector have been increasing except of IRDP and village industries, still if we take the figure of 1999, 2000, it is clear that micro credit for IRDP has been increased in 2002-03 by commercial banks.

Urban Co-operative Banks:

The governor mentioned that the Reserve Bank had again drawn attention to the present system of dual/triple regulatory and
### Table 6.2

**Commercial Banks* District Credit Plan Activity Wise**

<table>
<thead>
<tr>
<th>Activities</th>
<th>Period</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority Sector</td>
<td>131787</td>
<td>15725</td>
<td>127656</td>
<td>117560</td>
<td>205791</td>
</tr>
<tr>
<td>SSI (Other)</td>
<td>1639</td>
<td>915</td>
<td>199</td>
<td>290</td>
<td>5461</td>
</tr>
<tr>
<td>IRDP</td>
<td>49139</td>
<td>27959</td>
<td>45658</td>
<td>10640</td>
<td>41836</td>
</tr>
<tr>
<td>Village industries</td>
<td>4904</td>
<td>2984</td>
<td>1785</td>
<td>1840</td>
<td>2337</td>
</tr>
<tr>
<td>Rural Artisans</td>
<td>7439</td>
<td>5560</td>
<td>9539</td>
<td>7044</td>
<td>15263</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Activities</th>
<th>Period</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority Sector</td>
<td>176960</td>
<td>183861</td>
<td>230078</td>
<td>284336</td>
<td>328400</td>
</tr>
<tr>
<td>SSI (Other)</td>
<td>9174</td>
<td>6755</td>
<td>10526</td>
<td>13375</td>
<td>11895</td>
</tr>
<tr>
<td>IRDP</td>
<td>35998</td>
<td>20234</td>
<td>NA</td>
<td>NA</td>
<td>20585</td>
</tr>
<tr>
<td>Village industries</td>
<td>3912</td>
<td>632</td>
<td>3125</td>
<td>1750</td>
<td>3600</td>
</tr>
<tr>
<td>Rural Artisans</td>
<td>8810</td>
<td>6347</td>
<td>10140</td>
<td>6600</td>
<td>9250</td>
</tr>
</tbody>
</table>

**Note**:  * = Commercial Banks include Allahabad Bank, CBI, UBI, PNB, TGB
NA = Not available.

**Source**: District Credit Plan, Allahabad Bank.
supervisory control (involving centre, states and the Reserve Bank) and stated that it is not conducive to efficient functioning of cooperative banks in interest of their depositors. A committee under the chairmanship of Hon. Minister of State for Finance examined the issue and agreed that duality of control should be done away with and recommended that the Reserve Bank should be vested with full powers for regulation and supervision of Urban Cooperative Banks.

6.7 SUPERVISION AND MONITORING:

a. Risk Based Supervision:

The governor stressed that the Reserve Bank should switch over to risk based supervision of banks by 2003 and accordingly certain changes in management processes were initiated by the Project Implementation Group formed for the purpose.

b. Consolidated Accounting and Supervision:

The governor mention that in order to provide enabling provisions to facilitate consolidated accounting and quantitative methods under Indian conditions, a working arrangement with other regulators viz. Security and Exchange Board of India and Insurance Regulatory and Developing Authority for sharing of information by way of Memorandum of Understanding is being explored.

Prudential Measures:

The prudential norms are aimed at imparting strength to banks and financial institutions including greater accountability and market discipline
and creating a secure and conducive environment for the smooth and
effective functioning of the financial system\textsuperscript{12}. These norms cover not only
capital adequacy, assets classification and provisioning but also exposure
rules, accounting standards, transparency and disclosure, risk management
and asset liability management system. In this context RBI's approach
has been to benchmark the norms with international standards and
introduce the same after extensive consultations. It has also been a
standard practice to allow the participants to absorb changes incrementally
without causing any major dislocation.

a. **Adoption of 90 days norms for recognition of Loan Impairment**
   by State Cooperative Bank and District Central Cooperative
   Bank:

   With a view to moving towards international best practices and to
   ensure greater transparency. Commercial banks were advised to
   adopt 90 days norm for recognition of loan impairment from the
   year ending March 31, 2004. In order to have a cosistent and
   uniform approach towards all segments of the banking system, the
   90 days norm has been extended to state cooperative banks and
district central co-operative banks and from the year ending March
   31, 2006. To facilitate smooth transition, banks are advised to move
   over to charging interest on monthly rests from April 1, 2004.

b. **New Capital Accord:**

   The Governor mentioned that the Reserve Bank is continuing its
efforts towards obtaining international agreement on the proposals
on the New Capital Accord so that in its final version due next
year, it would provide sufficient flexibility for national regulation to take into account the differences in institutional framework and capacity in different countries, including developing countries.

c. **Bank’s Entry into Insurance Business:**
The Governor said that under the referred arrangement, banks provide physical infrastructure within their select branch premises to insurance companies for selling their insurance products to the bank’s customers with adequate disclosure and transparency and in turn earn referral fees on the basis of premia collected. Accordingly, a few banks have been permitted to enter into referral arrangement with insurance companies subject to certain conditions to protect the interest of their customers.

d. **Technical Committee on Market Integrity:**
The Governor mentioned that the Report of an internal Technical Group which assessed India’s position vis-a-vis internal standards on ‘market integrity’ has been placed on the Reserve Bank’s website for wider dissemination.

e. **Guidelines on ‘Know Your Customer’**

**Norms and cash transactions:**
Banks have been advised to put in place a sound ‘Know your customer’ policy, adopt anti money lending measures comprising systems and procedures for customer identification while opening accounts, institute internal control and audit mechanism, and lay down risk management and monitoring procedures.

f. **Offshore Banking Units in Special Economic Zones:**
The Reserve Bank has formulated a scheme of off shore banking unit in special economic zones as branches of banks operating in India and has obtained the approval of the government.

g. **Non-SLR Investments by Banks and Financial Institutions:**
Draft prudential guidelines on management of non-SLR investment portfolio have been referred to the RBI-SEBI Technical Committee to take a view of disclosure and regulation of private placement.

h. **Country Risk Management:**
Draft guidelines on country risk management together with a "Note for Discussion" were forwarded to banks and were also placed on the Reserve Bank’s website seeking comments/views thereon.

i. **Investment Fluctuation Reserve:**
The Governor recalled that with a view to building up of adequate reserves to guard against any possible reversal of interest rate environment in future, banks were advised to build up Investment Fluctuation Reserve. As per the extent guidelines, banks are required to build up Investment Fluctuation Reserve of minimum 5 percent within a period of 5 years.
NOTES & REFERENCES


