IX

Monetary and Banking Trends

The reserve Bank of India (RBI) has announced its annual monetary policy on April 29, 2008, for 2008-09. The policy places complete focus on price stability and attempts at curbing inflationary expectations. With that end in view, the RBI has raised the cash reserve ratio (CRR) by 25 basis points to 8.25 per cent effective from May 24, 2008. This has come close on the heels of CRR increase of 0.50 percentage point to 8.00 per cent in two installments of 0.25 percentage point each in April 26 and May 10.

In view of the persistent monetary overhang, the RBI has found it necessary to moderate monetary expansion and plan for reduced monetary growth. In the 2007-08 policy, the indicative target for M_3 growth was 17.0 - 17.5 per cent and for the latest 2008-09 policy, it is 16.5-17.0 per cent as against the average of over 21 per cent during 2005-08. Consistent with these projections of money supply, two more indicative projections are set out: aggregate deposits with scheduled commercial banks (17.0 per cent for 2008-09 as against an average of 23.3 per cent during 2005-08) which determine the lendable resources of banks; and growth of non-food credit including commercial investments by banks (placed at 20.0 per cent for the projection year as against the average of 29.7 per cent during 2005-08).

Table 9.1: Indicative Projections and Achievements of Key Monetary Variables (in per cent)

Year	M_3 Growth		Aggregate Deposits		Non-Food Credit	
	Target	Achievement	Target	Achievement	Target	Achievement
2008-09	16.5-17.0	-	17.0	-	20.0	-
2007-08	17.0-17.5	20.7	18.8*	22.2	24.0-25.0	22.3
2006-07	15.0	21.5	15.6*	23.8	20.0	28.4
2005-06	14.5	21.2	15.0	24.0	19.0	38.4

* Derived from absolute figures of projections

Recent Trends in Monetary Growth

The trends in the month of April have kept up the tempo of accelerated monetary growth. M_3 growth during the month ending April 25 has been 0.5 per cent as against 0.1 per cent during the corresponding month of the previous year (Table 9.2).

Almost all components of M_3 as well as sources of M_3 growth have experienced higher growth this year or have shown reduced rates of declines. A 3.7 per cent expansion in currency (Rs. 21,287 crore) appears very sizeable though fractionally lower than 3.8 per cent (or by Rs. 18,576 crore) in April 2007. Time deposit growth at 2.0 per cent in April 2008 (Rs. 57,585 crore) has been higher than that in April 2007 (1.6 per cent or Rs. 38,093 crore). Net foreign exchange assets of the banking system have grown by 1.4 per cent (Rs. 17,145 crore) as against an absolute fall of Rs. 28,025 crore (or –3.1 per cent).

The accelerations in the monetary growth and components are seen more sharply in the year-on-year growth. M_3 has increased by 21.2 per cent, as against 19.6 per cent recorded in the corresponding period of the previous year. Year–on-year basis, the currency with public has increased by 17.3 per cent for the year ending April 25, 2008, slightly higher than that a year ago (16.4 per cent). The growth in demand deposits has been much higher (20.6 per cent) in the current year as against marginal rise of 2.3 per cent in the previous year. On the other hand, the time deposits have remarkable growth of 22.3 per cent but slightly lower than that in the previous year. Measured on year-on-year basis, it has been observed that the net RBI's credit to government as on every Friday (weekly closure), has been amounting to huge negative implying that deposit liabilities against government including the funds received under market stabilisation scheme (MSS) of government, have been much larger than RBI's holdings of government securities and its ways and means advances to government. In view of the continuous rise and large holdings of deposits under MSS, net RBI's credit to government has been sizably negative. Thus, net RBI's credit to government during the year ending April 25, 2008, measured on-year-on-year basis, has registered a decline of Rs 179,031 crore as against a rise of Rs. 617 crore in the previous year. Due to the reasons of MSS, year-on-year basis, 'other banks' credit to government has registered a phenomenal rise of Rs. 208,014 crore, compared with an increase of Rs.62, 556 crore in the corresponding period of the preceeding year.

The 'other banks' credit to commercial sector, measured on year-on-year basis, has registered an whopping expansion of 21.8 per cent (Rs. 454,869 crore) as against of 25.0 per cent registered in the previous year (Rs. 417,240 crore). The NFEAs, measured on year-on-year basis, have expanded by Rs.399, 874 crore (or 45.2 per cent) on top of the rise of Rs.112, 898 crore (or 14.6 per cent) in the preceeding 12-month period.

Banking Trends

The behaviour of banking variables this year so far has followed a usual seasonal pattern. Generally after a year-end budge, there is considerable correction in the month of April each year, both in bank deposits and credit. This year too demand deposits have contracted by Rs. 56,524 crore in April 2008 as against a contraction of Rs. 52,059 crore in April 2007. This contraction is the result of year-end interest crediting by banks on term deposits, which augments the saving account balances towards March – end; such balances are withdrawn or deposited into other forms of time deposits in April. Accordingly, term deposits have expanded by Rs. 56,575 crore in April 2008 and by Rs. 33,290 crore in April 2007 (Table 9.3).

On the other hand, in credit, interest debiting may be taking place towards the end of March, particularly in cash credit accounts, which are repaid by the companies in April. In the olden days, there was a tendency on the part of the bank managers to force their clients to utilise cash credit towards the end of March so as to boost their balance sheet and unwind them in April. Now also, such a tendency may be seen but it is said to be waning. Non-food bank credit has contracted by Rs. 16,052 crore in April 2008 as against a contraction of Rs. 46,718 crore in April 2008. Year-on-year basis, demand and time deposits have witnessed growth rates of 21.9 per cent and 23.3 per cent, respectively, as at end – April 25, 2008, compared with 1.6 per cent and 25.7 per cent, respectively, witnessed in the preceeding 12-month period.

Losses on Currency Derivatives

The huge mark-to-market (MTM) losses on currency derivatives incurred by businesses are due to the adverse movements in the exchange rates and partly due to improper understanding of the product, on the part of banks and corporates that signed such derivative contracts. The banks that have suffered losses are enumerated below:

The country's largest bank, SBI is making a provision of Rs 40 crore towards potential losses owing to the meltdown in global credit markets. Earlier, two major private sector banks – ICICI Bank and Axis Bank – announced that they had taken hits on account of similar developments. Axis Bank has provided for Rs 72 crore, while its customers had suffered Rs 674 crore in MTM derivatives losses.

Kotak Mahindra Bank has recorded a net profit of Rs 69 crore in the fourth quarter of 2007-08 has made a provision of Rs 86 crore towards MTM losses on derivative trading. Also, the bank's customers have negative MTM exposures of Rs 612 crore in forex derivative transactions.

In the wake of the recent turmoil in banks on account of the credit derivative business, the RBI has decided to hold independent meetings with individual banks having high forex derivative exposures to understand the exact impact of their transactions and the extent of losses they have had to incur. In the meetings that expected to take place in coming weeks, the central bank would also seek to understand, if there has been 'mis-selling' by the banks as well as whether the RBI's current guidelines on the subject were adhered to. The central bank will seek to understand the circumstances that have led to the huge losses due to derivative trading, in its one-on-one meetings with the banks.

Meanwhile, the finance ministry has directed banks to set up a specialised monitoring system to assess the risks arising out of derivative trading. Besides, the finance ministry has asked banks to deal in products that the clients are comfortable with. In addition, banks may be required to fully explain the process including the pros and cons of the system in a bid to avoid any discord at a later stage. Public sector banks have already been asked to install a highly qualified team of experts to deal in the credit derivative business.

Acquisitions

Mumbai-based Abhyudaya Co-operative Bank is likely to acquire three co-operative banks; Udipi-based Janta Co-operative Bank, Baroda-based, Shree Krishna Co-operative Bank and Ahmedabad-based Manekchowk Co-operative Bank. The acquisitions will be completed by the end of June.

Chennai-based Indian Overseas Bank (IOB) has plans to acquire Shree Suvarna Sahakari Bank (SSSB), a Pune-based co-operative bank. The acquisition would help IOB to establish its presence in the western parts of the country, as expansion through an acquisition is easier. Currently, SSSB has 12 branches in Mumbai and Pune.

HSBC Financial Services Middle East has picked up a 4.99 per cent stake in Yes Bank in the secondary market. This is the second strategic investment made by the HSBC group in a bank after its investment in Axis Bank (earlier called UTI Bank). The group now holds a 4.96 per cent stake in Axis Bank. According to the RBI norms, foreign banks are allowed to buy up to 5 per cent stake in a bank.

Highlights

Corporation Bank has launched its reverse mortgage loan scheme for senior citizens, called ‘Corp Shelter’. This scheme is available to borrowers of at least 60 years of age and married couples are also eligible as joint borrowers.

South African private bank, FirstRand is opening its representative office in Mumbai. The bank has also sought permission from the RBI to open branches in Gurgaon, Chennai, Hyderabad, Bangalore and Coimbatore.

The RBI has raised the aggregate ceiling for overseas investment by mutual funds registered with Securities and Exchanges Board of India (SEBI) from US$ 5 billion to US$ 7 billion with immediate effect. The RBI move will give more flexibility to mutual funds in their overseas investments. As per the guidelines, the mutual funds are allowed to invest in ADRs and GDRs, equity of overseas companies listed on recognised stock exchanges, public issues, foreign debt securities, government bonds, derivatives, etc. Over half a dozen Indian funds have floated overseas schemes.

The RBI is now looking at strengthening local institutions like co-operative, regional rural banks (RRBs), urban co-operative banks (UCBs), small banks and self-help groups (SHGs) in a bid to bring in more people into the financial fold.