

# **Financial Liberalisation in India: Interest Rate Deregulation and Related Issues**

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A decorative graphic at the top of the slide consists of two groups of three circles. The left group has a solid light purple circle on the left, a white circle with a light purple outline in the middle, and a white circle with a light purple outline on the right. The right group has a solid light purple circle on the left, a white circle with a light purple outline in the middle, and a solid light purple circle on the right.

# Outline

- Important landmarks
- Deposit Rates
- Lending Rates
- Administered Rates
- Market Rates
- Policy Rates
- Related Issues



# Landmarks in Indian Finance

- Financial development to support Planning
- Nationalisation of Insurance, nationalisation of banks 1956, 1969, 1980
- Institutional Development- Supply leading role
- 1970s and 80s—expansion phase
- Mid-80s—consolidation phase
- Chakravarty committee report- 1985
- Post reform period—90s onwards Liberalisation and market development—from financial repression to deregulation
- 1992—Stock market scam
- Narasimham committee I and II
- Tarapore committee—I and II
- Reddy Committee and Rakesh Mohan committee-2000, 2009



# Major characteristics of Indian finance

- Government domination
- Multiple agencies
- Multiple regulators
- Conservatism and gradualism
- Managed capital account

# Important landmarks

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- Beginnings: Mid- 1980s-Rationalisation
- Freeing of Money market rates-late 1980s
- Freedom to fix lending rates-early 1990s
- Government securities rates- Auctions-early 1990s
- Elimination of automatic monetisation-1997
- Fiscal consolidation-2003, 2006
- Activation of policy rates- Bank Rate, Repo and Reverse Repo rates—late 1990s, 2001
- Benchmark Prime Lending Rate—2003
- Base Rate-2010
- Pending reforms: Savings Accounts, Non-resident deposits, Contractual Savings

# Policy Direction

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- The policy on interest rates has undergone a sea change since the onset of reforms in the early 1990s. This has impacted the way in which policy interest rates are set by the Reserve Bank, and how market interest rates, in particular on loans, are determined.
- Two general policy objectives came into being: first, to make interest rate determination more transparent and competitive in the system; and second, to make markets respond to policy interest rate changes so that the 'rate channel' transmission of monetary policy becomes more effective.

# Savings Deposit rate

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- The annual policy announced on April 29, 2002 considered the liberalization of savings bank deposit rate, but decided to continue with the administered structure. To quote:
- *“In view of the present deregulated interest rate environment and the reduction in interest rates on Government’s small savings schemes in the recent period, there is an apparent case for deregulation of interest rates on savings account also. However, considering the fact that bulk of such savings deposits are held by households, including households in rural and semi-urban areas, on balance, it is not considered as opportune time to deregulate the interest rate on savings account for the present.”*

## **SB deposits cont'd**

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- SBDs like in other countries could offer minimum facilities such as withdrawal and ATM/debit card with modest interest payment but it may not offer cheque writing facility.
- Since strict KYC norms in the context of ALM/CFT will arise only in the case of chequable accounts, SBDs may in principle be treated on par with 'no frill' accounts. There need not be a distinction between SBDs and 'no frills' accounts. Interest rate on such accounts may be totally be freed.



# Small savings schemes

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- Thirteenth Finance Commission: “the design and implementation of the NSSF be examined with a view to introducing transparency, market-linked rates and other necessary reforms”.
- First, small saving schemes cannot be viewed in isolation from other major financial instruments such as bank deposits and mutual funds. A fragmented approach focusing only on NSSF may at best result in some incremental reforms, without removing distortions.
- The treatment of small savings schemes has to be viewed in the broader perspective of reforms in respect of financial savings/instruments as a whole; this is in order to develop an efficient capital and debt market as also make more effective the monetary policy transmission mechanism through interest rates.
- Second, small savings schemes as they exist at present, possess a mixture of different type of saving instruments, some akin to deposits and others in the nature of old age security schemes. The future of these schemes has to be assessed in the light of banking and financial sector developments, and pension fund reforms.

# **Government securities market: Role and significance**

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- Public debt— an instrument of fiscal policy
- Gsec market—a conduit for central bank operations
- Sets benchmark for other debt instruments
- Prerequisite for development of debt market

## **Primary market –issuance procedures**

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- Floatations—pre-reform period—fixed coupons issued at par
- Captive market
- Passive management of debt
- Post-reform :Auctions—
- yield based and price based
- Auctions— uniform price and multiple price
- Winners' curse

## Tbills

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- 91 day auction every Wednesday—settled on Friday-
- 182/364 day bills– auctions on alternate wednesdays preceding reporting fridays-settled on friday

# Dated Securities

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- Auctions as per calendar
- Features to know—
- Coupon—hy payments
- Fixed rate
- Floating rate
- indexed

## **Debt and Monetary management**

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- Is there a conflict?
- Coordination or separation?
- Division of responsibilities
- State loans vs central loans
- Expertise
- Current thinking

# Policy Rates

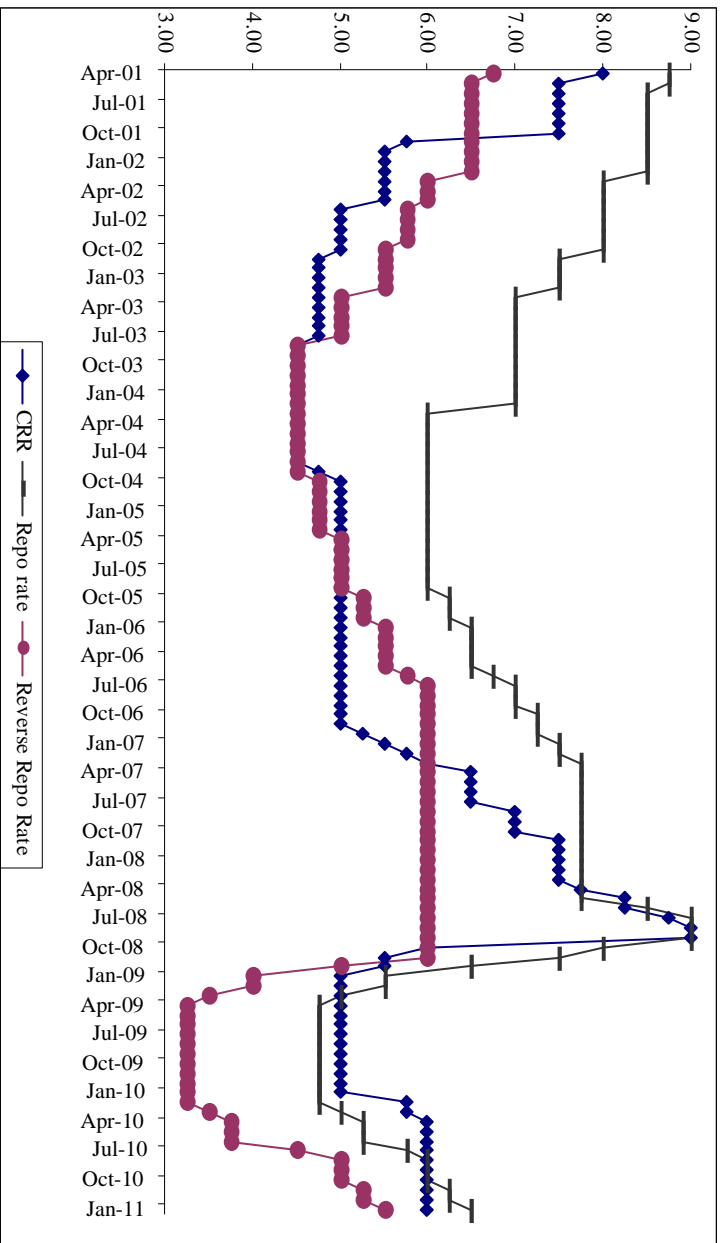
**crr**

**repo**

**r. repo**

	<b>crr</b>	<b>repo</b>	<b>r. repo</b>
Jan-10	5.00	4.75	3.25
Feb-10	5.75	4.75	3.25
Mar-10	5.75	5.00	3.50
Apr-10	6.00	5.25	3.75
May-10	6.00	5.25	3.75
Jun-10	6.00	5.25	3.75
Jul-10	6.00	5.75	4.50
Aug-10	6.00	6.00	5.00
Sep-10	6.00	6.00	5.00
Oct-10	6.00	6.00	5.00
Nov-10	6.00	6.25	5.25
Dec-10	6.00	6.25	5.25
Jan-11	6.00	6.50	5.50

# Policy phases





# Easing and Tightening phases

	<b>Phase I</b>	<b>Phase II</b>	<b>Phase III</b>	<b>Phase IV</b>
	April 2001- 2002 to August 2004	September 2004 to Septem ber 2008	October 2008 to Januar y 2010	February 2010- <b>December 2010</b>
Monthly Average WPI	4.4	5.8	3.8	9.7
Monthly Average CPI*	3.9	5.9	11.0	12.0
Monthly Average M3	15.0	18.7	19.8	15.5
* - data available up to November 2010				

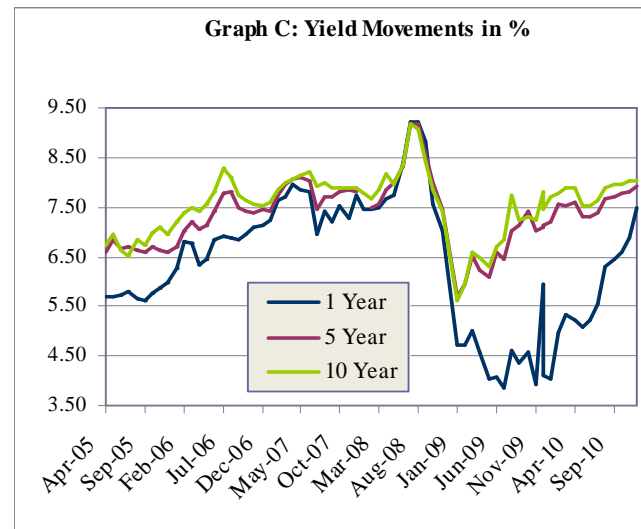
# Base Rate changes

<b>Base Rate</b>		
	<b>With effect from 1, July 2010</b>	<b>Latest revision</b>
1 Axis Bank Ltd.	7.50	8.25
2 Allahabad Bank	8.00	9.50
3 Andhra Bank	8.25	9.50
4 Bank of Baroda	8.00	9.50
5 Bank of India	8.00	9.50
6 Bank of Maharashtra	8.00	9.50
7 Corporation Bank	7.75	9.40
8 Central Bank of India	8.00	9.50
9 Canara Bank	8.00	9.50
10 Dhanlaxmi	7.00	8.25
11 Dena Bank	8.25	9.45
12 HDFC Bank	7.25	7.75
13 IDBI	8.00	9.50
14 ICICI Bank	7.50	8.25

## Base Rate changes-contd

16	Indian Bank	8.00	9.50
17	Indian Overseas Bank	8.25	9.50
18	Kotak Mahindra Bank	7.25	8.25
19	Karnataka Bank Ltd	8.75	9.75
20	Oriental Bank of Commerce	8.00	9.50
21	Punjab National Bank	8.00	9.50
22	Punjab & Sind Bank	8.20	9.50
23	SBI	7.50	8.25
24	State Bank of Bikaner & Jaipur	7.75	8.75
25	State Bank of Hyderabad	7.75	9.00
26	State Bank of Mysore	7.75	8.75
27	State Bank of Patiala	7.75	9.00
28	State Bank of Travancore	7.75	9.00
29	Syndicate Bank	8.25	9.50
30	UCO Bank	8.00	9.50
31	United Bank of India	8.25	9.45
32	Union Bank of India	8.00	9.50

# Yield trends



# Yield spread and IIP

