

# Credit Expansion During the Current Busy Season

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*The data regarding agricultural and industrial production and foreign trade during 1954-55 and 1955-56 do not provide any explanation for the higher rate of increase in bank credit in the present season as compared to the previous one. The presumption is strong that this year's increase has been fostered by the speculative holding of commodities. Unfortunately there is some amount of truth in the contention that the Reserve Bank of India and the State Bank ivcre partly responsible.*

*The high rate of utilisation of cash balances by the banks for the expansion of credit is a matter of serious concern and provides the justification for arming the Reserve Bank with the authority to vary cash ratios. Selective credit control though useful, is not likely to be effective by itself.*

THE expansion in the total volume of bank credit granted by the scheduled banks, during the current busy season as also the factors that have facilitated it merit careful consideration. The financing of the Second Plan would involve the creation of large quantities of currency. In fact the total money supply has increased in 1955-56 by about Ra 260 crores, and this is larger than the additions to the money supply in the two preceding years. The behaviour of bank credit under the impact of this factor has got to be watched with a critical eye in the interest of monetary stability.

Certain facts bearing on the situation should be noted at the outset. The present busy season started from October 15, 1955 and from this date to March 30, 1956, the total bank credit granted by the scheduled banks increased by Rs 172.4 crores; total deposits by Rs 18.56 crores; borrowings from the Reserve Bank by Rs 58.84 crores and from the State Bank by Rs 14.76 crores. Total cash balances also declined by Rs 8.4 crores and investments by Rs 30.49 crores.

The accompanying table contains the data relating to the expansion Of bank credit in the last five busy sasons. It will be seen that, excepting the busy season of 1950-51, all the other immediately preceding busy seasons witnessed an expansion of bank credit on a much smaller scale than that in the present season. The average rate of expansion in bank credit in the last five busy seasons, 1950-51 to 1954-55, was Rs 118 crores, against Rs 172 crores in 1055-56, and this amount would rise still more by the time the present busy season is over.

Are there any special factors at work during the present season which may explain the rather large expansion in bank credit? But unfortunately the data regarding agricultural and industrial production and foreign trade in the two years, 1955-56 and 1954-55, do not provide any explanation for the higher rate of increase in bank credit in the present season as compared to that in the previous one. The average level of agricultural production during the current year is admitted to be lower than that in 1954-55. The total volume of exports during the eleven months of 1955-56 for which statistics are available is almost the same as that in the corresponding period of 1954-55. The Reserve Bank's price index of exports was 93 during the last quarter of 1955,— about 8 per cent below that in the same period of the previous year. The price index of imports, however, was higher by about 3 per cent— during the same period of both these years. The busy season of 1950-51 witnessed an expansion in bank credit which was slightly larger than that during the present. This ex-

pansion took place under the impact of the inflationary upsurge generated, by the Korean War. The Annual Report of the Reserve Bank ascribed the high rate of increase in bank credit in that year to "the need to finance trade and movement of commodities at rising prices, to the continued high level of exports as well as to a degree of speculative holding of commodities". The general index of prices rose by 11 per cent during the busy season of 1950-51 and by 8.7 per cent during that of 1955-56. In the former year the value of exports was also larger than that in the latter. It is, therefore, difficult to find adequate justification for the expansion in bank credit that has taken place in the current busy season when all the relevant factors are examined in relation to the years 1954-55 and 1955-56. The presumption is strong that this years rise in bank credit has also been fostered by the speculative holding of commodities as was the case during the busy season of 1950-51.

Moreover, this year's expansion in

**Changes in Total Credit and Deposits of Scheduled Banks**  
(crores of rupees)

Season	Credit	Deposits
Nov. 25 - May 11 1950-51 (B)	+ 180.29	+ 21.81
May 12 - Oct. 26 1951 (S)	— 85.86	— 19.74
Oct. 27 - March 7 1951-52 (B)	+ 99.96	— 27.49
March 8 - Nov. 21 1952 (S)	— 131.61	+ 5.58
Nov. 22 - May 8 1952-53 (B)	+ 85.87	— 16.30
May 9 - Nov. 20 1953 (S)	— 89.75	+ 15.39
Nov. 21 - May 7 1953-54 (B)	+ 112.26	— 3.80
May 8 - Oct. 15 1954 (S)	— 61.67	+ 57.11
Oct. 16 - April 8 1954-55 (B)	+ 109.13	+ 48.62
April 9 - Oct. 14 1955 (S)	— 34.14	+ 58.62
Oct. 15 - March 30 1955-56 (B)	+ 172.4	+ 18.86

(B) denotes busy season and (S) slack season.

bank credit should be studied against the background of the events which took place in the previous slack season. In the busy season of 1954-55, lasting from October 16 to April 8, bank credit increased by Rs 109.13 crores. In the ensuing slack season, bank credit contracted by only Rs 34.14 crores. Thus only 31.3 per cent of the additional bank credit created during this busy season returned to the banks in the slack season. This rate of contraction of credit in the slack season is much lower than any during all previous slack seasons. The rate of contraction in the slack season of 1951 was 47.7 per cent of the previous expansion in bank credit, and even this rate was regarded by the Reserve Bank as extremely unsatisfactory. This lower rate of contraction of bank credit was stated to be one of the reasons for raising the Bank Rate in November, 1951. The rate of contraction in the slack season of 1955 is the lowest on record. The average rate of contraction of bank credit during the five preceding slack seasons works out at 86.6 per cent of the expansion in bank credit in the previous busy seasons. Had bank credit contracted by the average rate in the slack season of 1955, it would have declined by at least Rs 94 crores. Thus by the end of the slack season of 1955, the economy had retained about Rs 00 crores of the additional credit created

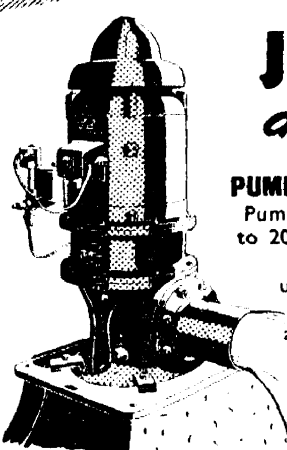
during the last busy season. The expansion of credit in the present busy season by Rs 172 crores has thus been super-imposed over an already inflated economy. No wonder, therefore, that the ratio of advances to deposits rose to an all-time high of 73.02 per cent. The previous highest ratio was 69.6 per cent at the end of the busy season of 1951-52, and the high ratio was brought about partly by the decline in total deposits by Rs 26 crores which took place during that season. But during the present busy season, the total deposits have, on the other hand, increased by Rs 18.86 crores.'

The rate of expansion in bank credit in the last few months should have been checked, especially when

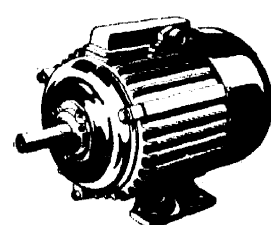
In a summary of the Annual Report on the Trend and Progress of Banking in 1955, released to the press, the relatively small contraction in bank credit in the slack season of 1955 has been ascribed to "the beginning of the growing diversification of the Indian economy", leading to a general rise in credit demands. It is rather difficult to accept this as a valid explanation of such a disquieting trend. Surely diversification of the economy cannot have proceeded in course of one year at such a pace as to justify an increase in total bank credit from Rs 109 crores to Rs 172 crores and a decline in the rate of contraction in credit in the slack season from 55 per cent in 1954 to 31 per cent in 1955.

it was found that the rate of contraction in bank credit in the last slack season was extremely unsatisfactory. Unfortunately there is some amount of truth in the contention that the Reserve Bank had also some share in this expansion process. Scheduled banks' borrowings from the Reserve Bank were the highest, being Rs 65.08 crores on 30th March, 1956. Such borrowings remained above Rs 10 crores in 10 months of the year, 1955-56, as against only 5 months in 1954-55 and 1953-54, 4 months in 1952-53 and 6 months in 1951-52. The Annual average of borrowings from the Reserve Bank formed in 1955-56 3.8 per cent of the total scheduled bank credit as compared to 2.6 per cent in 1954-55, less than 2 per cent in 1953-54 and about 2 per cent in 1952-53. Of the additional bank credit created by the scheduled banks, 8.5 per cent came from the Reserve Bank in March, 1956, and 5.8 per cent in March, 1955. 5.7 per cent in March, 1954 and only 3.5 per cent in March, 1953. Thus the Reserve Bank's share or compliance in this process of expansion of bank credit was also not inconsiderable. The State Bank of India has also some responsibility in this matter since its nationalisation. Borrowings from the State Bank amounted to an all-time high figure of Rs 19.71 crores on the last week of March, 1956, as against only 8.07 crores in

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the same period of the previous year.

The daily step taken by the Reserve Bank was to raise the rate for advances under the Bill Market Scheme from 3 per cent to 3½ per cent as from March 1, 1956 and to withdraw the concession granted to banks hitherto in respect of the stamo duty. This of course resulted in some slight shift away from the method of borrowing through the Bill Market Scheme, the ratio or such borrowings to the total borrowings from the Reserve Bank declining from 51.8 per cent in February, 1956 to 45 per cent in March, 1956. But there is no evidence that it has restricted the growth in the volume of borrowings from the Reserve Bank or in that, of bank credit. It is difficult to understand why the Reserve Bank failed to take suitable steps to arrest this rising trend in bank credit, especially as the contraction of bank credit in the slack season was inadequate, and as the ratio of advances to deposits rose above 70 per cent inspite of some rir% in bank deposits. There was, moreover, no underlying factor in the economy to justify such a heavy rate of expansion m bank credit. On the other hand, there is a good deal of danger in this nroecess, especially when a faster rate of expansion in currency is going on simultaneously. The other constituent of the money supply viz: bank credit, could not be allowed to proceed at the same time at more than the average pace. An increase in the Bank Rate by (say), half per cent at the beginning of 11'56 would not have probably been a bad thing to do. It could have prevented increased resort to borrowing from the Reserve Bank by serving a sort of warning to the banking system to go slow. Tune has, moreover, arrived 'when the Reserve Bank should seriously take up the consideration of evolving a convention to the effect that loans to a bank would be granted only under exceptional circumstances when the ratio of its advances to deposits is near about 70 per cent. As a general rule, banks should regard that ratio as the ceiling, and they should try to remain well within this 'limit, and when the actual ratio is approaching near this figure they should go to sources other than the Reserve Bank or the State Bank for loans.

Another noticeable trend has been the running down of excess balances Which seems to have been the practice with the scheduled banks in the last 3, or 4 years. They are increasingly using up their cash balances in their

search for resources? for financing the expansion in advances. Thus throughout 195'5-56, banks maintained lower cash reserve ratios than those of earlier years. In that year, this ratio never rose above 9.04 per cent while the maximum was 13.16 per cent in 1954-55, 10.16 per cent in 1953-54, and 11.40 per cent in 1952-53. It was still higher in earlier years. In third week of March, 1956, the ratio declined to the lowest figure of 7.8 per cent. Throughout the year, 1955-56, the ratio was always below 9 per cent except in two months, whereas it was above 9 per cent in six months of 1954-55, 5 months of 1953-54, and 11 months of 1952-53. The banks have thus been raiding their cash balances during the last lour years in order to increase their advances, helped, no doubt, by the growth in habits of rediscounting. In the five years 1950-51 to 1955-56, the total deposits of the scheduled banks have increased by about 16 per cent, while their total cash balances have actually declined by 8.7 per cent.

The result has been the considerable decline in the amount of excess balances possessed by the scheduled banks. The excess balances have fallen from an annual average of Rs 18.89 crores in 1954-55 to Rs IS.93 crores in 1955 56. On March 23, 1956, the *excess* balances came down to the low level of Rs 6.89 crores. We already know that the growth in bank credit in the busy season of 1950-51 was larger than that in 195.5-56. But in that year the excess balances at the end of the period were 1.5 per cent of the total deposits against only .84 per cent on 30th March, 1956,

It may be urged that there is nothing alarming in this process. These excess balances represented potential lending capacity, and once banks use them up, their dependence on the Reserve Bank for any additional funds would be complete. Our banking system would then come closer to the British, rather than to the American organisation. In the meantime the range of fluctuations in the cash reserve ratios has tended to come closer on account of this factor. In 1955-56, the cash reserve ratios have remained within the limits of 9.04 per cent to 8.08 per cent, against 11.16 per cent and 8.28 per cent in the previous year. Disappearance of fluctuations in this ratio may prove to be an important factor perfecting the control mechanism of the Reserve Bank.

But this rate of utilisation of excess balances is certainly a matter of serious concern at a time when the economy has also to absorb large injections of currency. In view of the increasing resort to deficit-financing which, might become necessary in course of the Second Five Year Plan, such activation of idle balances is fraught with grave danger. It is this fact which provides the justification for arming the Reserve Bank with the authority to vary the cash reserve ratios. Such an authority ought to have been granted to the Reserve Bank long ago. The high rate of expansion of bank credit during the present busy season could have been checked had the Reserve Bank raised the cash reserve ratios by, say, one per cent. That might have slowed down the process of speculative hoarding of commodities, and so made the rate of adjustment of the relative price levels of agricultural and manufactured goods more smooth and less alarming. It is never too late to learn, and let us hope that the Reserve Bank would not fail to »use this power vigorously and timely for keeping the growth in bank credit within proper limits. Recourse to the method of selective credit control, though belated, has Its undoubted use. But it is not likely to make any significant impression on the growth of total bank credit, except indirectly, and it is not an easy method to administer. The use of the instrument of variable reserve ratios in conjunction with the selective credit control is, therefore, absolutely essential for steering the banking system along the desired direction.

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