Special Monthly Feature

Post-War Developments In Banking In India

JUDGED by the accepted criteria, there has been a rapid growth of banks and banking in India in the past decade. In the pas ten years, the banking system had not only geared itself to war economy but had acclamatised itself to peace conditions, without, any permanent scar or inquiry. This is a creditable achievement, and it would be uncharitable not *to* acknowledge the remarkable progress and the strength and solidity of the banking structure.

During the war and the immediate post-war period, there was a rush for the formation of new banks; also, there was a tendency for some of the under-capitalised war-time banks to estaiblish branches in key trading centres like Bombay, Calcutta, Madras and Kanpur. By 1946, the latter tendency had been checked. Some new bank;; had been started during and since the war, but, unlike the growth of mushroom banks during 1914-18, the banks formed this time were big institutions with adequate capital resource::. And, by 1946, new banking formations had ceased.

In between 1938 and 1946, banking offices increased from 1,128 to 3,469. Since the beginning of the war upto the week ended December 10, 1948, bank deposits improved from Rs. 236.60 crores (undivided India) to Rs. 961.72 crores (partitioned India). Of this banking growth, it is interesting to note that the "other scheduled banks" made a more rapid progress than the Imperial Bank or the exchange banks. Although the total number of bank branches registered a three-fold increase, the number of branches of exchange banks declined; the branches of "other scheduled banks'' developed more rapidly than those of the Imperial Bank Despite the relative expansion of "other scheduled banks", the Imperial Bank, however, continues to dominate the field, although, in the past decade, the deposits of the latter have fahen from one-half to one-third of the total deposits of all the scheduled banks taken together.

This raises the problems of the nationalisation of the Imperial Bank. Now that the Reserve Bank have been taken over by Government, the question is being asked whether it is possible to make finance a handmaid of industry with the biggest joint-stock bank in the country func tioning as a private institution. True, the domination of the whole banking system by a single institution is not peculiar to India; the Midland Bank in Britain and the National City Bank in America occupy the same position as the Imperial Bank doe in India. There is, however, a significant difference in the conditions prevailing here and those obtaining in Britain and America. Neither the Midland nor the National City enjoy government patronage or privileged status; unlike the Imperial Bank, they do not act as agents of Government or of the Centra! Bank; both function and compete with the other banks on equal terms. Whether the Imperial Bank is nationalised or not scheduled banks are justified in demanding that it should at least be deprived of its official patronage, so that they can compete with it on equal terms

That much about the quantitative growth of banking during and since the war. But the rapid development in size and structure can be a danger unless it is accompanied by qualitative growth. Has the growth been on sound and proper lines? That banking failures have been few. is a prima facie indication that there is nothing seriously wrong with the Indian banks. Banks are supposed to be a strong as they are liquid. Tested on this criterion, the banking system seems to be sound.

Scheduled banks' cash ratio had improved during the war. It is now at the more reasonable level of approximately 12 p c. During the war, the ratio of investments to deposits also improved. By 1946, the ratio had declined, only to improve subsequently as the anticipated increase in bank advances did not materialise. War-time controls had caused a decrease in the trade demand for funds for f- ancing the usual shocks. Controls have now been reintroduced.

Meanwhile, the expectation that the post-war renovation of plant and machinery would lead to an improvement in bank advances had proved false. For one thing, industry had accumulated large sums as E.P.T. deposits. Besides;, it has been financing its requirements either out of accumulated reserves or bank deposits or through issues of bonus shares. As a result of all these factors, the banks still remain liquid, though the extent of liquidity now is not as much as during the war period.

That banks have become investment trusts, is widely known. This phenomenon antedates the war, although wartime developments nave accentuated it. In some countries like Australia and Canada, there are now statutory restrictions on purchases of government securities by banks. In Britain and America, the major portion of banks' investments is in short-dated securities. In India, however, banks seem to prefer investments in long-term loans, presumably because of their higher earning capacity.

This has been a matter for comment by Sir Chintaman Deshmukh, Governor, Reserve Bank of India. On the argument that the maturity distribution of bank's investments should be so regulated as to conform to their varying liabilities, the Reserve Bank issued a directive that banks should give up their preference for long-dated securities. There may be something in this argument, but it is liable to be over emphasised. The Indian gilt-edged market is quite broad and active, it can absorb occasional liquidation by insti tutional investors. On the other hand, the need for such liquida-. tion, as occasions demand, 'cannot be avoided by what has been called "a more balanced" maturity distribution.

Any discussion about 'banking assets must remain incomplete without an examination of bank advances. That bank advances have been, and are, insignificant, is known. Also known is the fact that bills of exchange have not taken root in India. These are longstanding and pronounced features of banking, not only in India but throughout the world. This apart, it is not possible to have an objective discussion of this aspect of banking as detailed statistics are not available.

Yet, the belief is widely held that a major portion of bank advances represents speculative demand for funds and not genuine accommodation to trade and industry. Self-financing by trade and industry is an established feature. In the circumstances, bank advances in India must necessarily be more speculative in nature; all the more so as business in India is, as yet, mostly speculative.

Relative unimportance of business deposits in India is apparent from an examination of banks' liabilities. A detailed examination has been undertaken by the Research Department of the Reserve Bank on the nature and composition of bank deposits. Figures up to December 31, 1946 are available, and indicate significant trends. On that date, the percentage of business to total deposits was 41.59 for India, 67.27 for Britain and 56.30 for America; by the end of 1946, business deposits had begun to decline in India and America, although they remained stationary in Britain.

As on December 31, 1946, the percentage of personal to total deposits was 40.85 for India, 32.73 for Britain and 37,15 for America. These percentages are not strictly comparable as the figures for India perhaps include deposits of small traders. To some extent, the relative importance of personal deposits in India is a reflection of the wartime rise in wages and salaries; it is also perhaps, an evidence that banking habits are growing. The latter is a welcome development, although it is equally a reminder of inflationary potentialities and of the need for energetically pursuing anti-inflationary measures.

Distribution of Bank Assets

By "Analyst"

THE inflationary conditions prevailing during the war were aggravated during the post-war period and were duly reflected in the pattern of liabilities and assets of banks. While the deposits of scheduled banks had increased at a slower rate than the note circulation during the war years, in the post-war period they increased faster. In other words, credit inflation followed currency inflation, when the banks were called upon to meet the expanding demand for credit on the part of trade and industry. During the war a major part of the total expenditure in the country was incurred by the Government and economic activity in the private sector had been restricted by controls over commodities and investments. Therefore, although bank deposits rose rapidly as a result of increase in money incomes, the scope for expansion of credit for financing private business activity remained limited while the system of direct payment by Government for war contracts, the so-called "progress payments", partially dispensed with the need for bank accommodation. In consequence, the percentage of advances and bills to total deposits went on declining. The banks, therefore, held a larger proportion of their assets in the form of government securities, the supply of which was steadily increasing, and allowed their liquid resources, i.e., cash and balances with the Reserve Bank, to mount up.

With the end of the war the expenditure of the Government on its own behalf and on behalf of the Allied Governments tapered off and economic activity shifted from the governmental to the private sector. The war time pattern of the distribution of bank assets also changed accordingly. The relaxation of controls and restrictions imposed on trade and industry gave a fresh impetus to private activity and stepped up the demand for loans on the part of industrialists and businessmen. Advances and bills which had dropped as low as 29 per cent of the total liabilities in September 1945 slowly moved up to 47 per cent in March 1947 while the cash ratio declined from 16 to 10 per cent. The proportion of investments to total liabilities also registered a modest fall and banks did not remain as liquid as they had been during the war. Business activity also increased as a result of the greater availability of consumers' goods for which there was a huge pent-up demand. The general rise in prices also augmented the demand for credit required to finance the purchase and movement of goods.

Further, bank credit was drawn upon for financing speculation on the stock exchange

ASSETS AND LIABILITIES OF SCHEDULED BANKS

(in crores of rupees

	1938-39	Sept. 1945	March 1946	Sept. 1946	March 1947	Sept. 1947	March 1948	Sept. 1948
' 1 Notes in Circulation	174	1147	1217	1198	1243	1180	1304	1313
2 Demand Liabilities	124	644	704	750	690	700	751	784
3 Time Liabilities	103	254	296	320	347	346	340	324
4 Total Liabilities	227	898	1000	1070	1037	1046	1091	1108
5 Advances and bills	116	265	361	416	488	418	493	434
6 Cash and balances	23	145	118	126	108	157	123	158
7 Percentage of (5) to (4)	51	29	36	39	47	40	45	31
,, ,, (6) to (4)	10	16	12	12	10	15	11	14
,, investments to total liabilities	39	55	52	49	43	45	44	55

' Indian Union and Pakistan figures have been added up in order to maintain comparability with previous figures.

Note:—September and March figures have been given for each year to show the position in the slack season and the busy season respectively.