

# STRUCTURE OF INTEREST RATES IN INDIA

K. KRISHNAMURTY\*

THE object of this study<sup>1</sup> is (i) to quantify the inter-connection between short and long-term rate of interest in the organized money-capital markets of India; and (ii) to find a relation between short-term rate of interest and excess reserves of the scheduled banks and the bank rate.

There is an array of short rates that can be considered in the analysis. The term short rate may refer to either one of the following: treasury bill rate, inter-bank call rate, commercial bill rate, the deposit and lending rates of commercial banks and, finally, the bank rate. In addition to these another short rate that can be considered is the bazaar bill rate. In this analysis three rates are tried. The first one ('s<sub>1</sub>) is the average of treasury bill rate and three month deposit rate of the State Bank of India (or its predecessor, the Imperial Bank of India) and other major scheduled banks at Calcutta and Bombay. The second one ('s<sub>2</sub>) is the average of the earlier one and the average call loan rate of the State Bank of India (or its predecessor Imperial Bank of India) and other major scheduled banks at Bombay and Calcutta. The third rate ('s<sub>3</sub>) is the average of the first ('s<sub>1</sub>), the average call loan rate and the average bazaar bill rate at Bombay and Calcutta. Similarly, long-term rate may refer to Government and corporate bond rates, yield on ordinary and preference shares. Government, being an important borrower of funds, plays a dominant role in money-capital markets of India. The yield on long-term Government bonds is often considered to represent the long rate. In this study the percentage yield on Government of India non-terminable three per cent Rupee paper is used to represent long-term rate of interest.

## *Long-Term Rate of Interest*

It is commonly stated that the long-term rate of interest is a moving average of the expected short-term rates.<sup>2</sup> On the assumption that the expectations of the investors about the future movements of short-term rates are based on their experience of the course of short-term

\* I am grateful to Prof. L. R. Klein and Dr. C. Ranga Rajan for their helpful suggestions in course of the work incorporated in this paper.

<sup>1</sup> Data for the study are obtained from Reports on *Currency and Finance* and various issues of *Reserve Bank of India Bulletin*, Reserve Bank of India.

<sup>2</sup> Hicks, J.R., *Value and Capital*, Oxford, Second Edition, 1964, p. 145; Kalecki, M., *Theory of Economic Dynamics*, George Allen and Unwin, 1954, pp. 73-88.