

THE STRUCTURE OF INTEREST RATES IN INDIA

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THE concept of the rate of interest as used in economic theory has been a general and wide one to represent various rates of interest prevailing in an economy. This may be useful in making an aggregative study of general equilibrium, but it certainly does not reflect on the true nature and behaviour of rates which differ from one another on account of (i) differences in the length of time for which loans are to run and in the way repayment is to be distributed over time; (ii) differences in the risk of default by the borrower [1]. Thus, there emerge two distinct classes which cover a host of interest rates at a given time. In general, rates on the securities which mature within one year of issue are called short-term rates and those on the securities which mature after one year long-term rates. The way in which various interest rates are determined by the market forces of the demand for and the supply of funds depends largely upon the influence of other economic variables like money supply, national income, volume of transactions etc., and on the inter-connection between various rates of interest. In a dynamic situation the structure thus determined itself undergoes changes and directs the movement of all interest rates over time.

Inter-connection between different interest rates is of crucial importance in so far it can be explained in terms of the difference in the period of maturity of different loans. Interest in the examination of these inter-connections and determinations in quantitative terms is of recent origin. Though the theory of interest rate determination (referring to a single representative rate and not different rates) has not yet reached a level of consensus among economists, yet there have emerged two major versions—the Hicks-Lutz version and the

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