*Governor's Statement**

Shaktikanta Das

As we celebrate India's 77th Independence Day in a few days, I am happy to note that the Indian economy is exuding enhanced strength and stability despite the massive shocks to global economy in recent years. Our economy has continued to grow at a reasonable pace, becoming the fifth largest economy in the world[1] and contributing around 15 per cent to global growth. We have also made significant progress towards controlling inflation. Our banks remain healthiest in more than a decade with historically high levels of capital, declining levels of non-performing assets and rising profitability. Corporate balance sheets are robust, with lower leverage, improving debt servicing capacity and strong profitability. Lower current account deficit and ample capital flows have imparted strength to our external sector. The resultant accretion to forex reserves has provided a buffer against external shocks. Overall, India's strong macroeconomic fundamentals have laid the foundations for sustainable growth.

In a moment like this, we need to continue with our efforts to maintain macro-financial stability while pushing our growth frontier further. India is uniquely placed to benefit from the ongoing transformational shifts in global economy in the wake of geopolitical realignments and technological innovations. A large economy marching ahead with vast domestic demand, untapped resources and demographic advantages, India can become the new growth engine for the world.

Decisions and Deliberation of the Monetary Policy Committee (MPC)

The Monetary Policy Committee (MPC) met on 8th, 9th and 10th August 2023. After detailed deliberation on all relevant aspects, it decided unanimously to keep the policy repo rate unchanged at 6.50 per cent. Consequently, the standing deposit facility (SDF) rate remains at 6.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 6.75 per cent. The MPC also decided by a majority of 5 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.

Let me now explain the MPC's rationale for these decisions on the policy rate and the stance. Headline inflation, after reaching a low of 4.3 per cent in May 2023, rose in June and is expected to surge during July-August led by vegetable prices. While the vegetable price shock may reverse quickly, possible *El Niño* weather conditions along with global food prices need to be watched closely against the backdrop of a skewed south-west monsoon so far. These developments warrant a heightened vigil on the evolving inflation trajectory. The cumulative rate hike of 250 basis points undertaken by the MPC is working its way into the economy. Nonetheless, domestic economic activity is holding up well and is likely to retain its momentum, despite weak external demand. Considering this confluence of factors, the MPC decided to remain watchful and evaluate the emerging situation. Consequently, the MPC decided to keep the policy repo rate unchanged at 6.50 per cent with preparedness to act, should the situation so warrant. The MPC remains resolute in its commitment to aligning inflation to the 4 per cent target and anchoring inflation expectations.

Further, with monetary transmission still underway[2] and headline inflation remaining higher

* Governor's Statement - August 10, 2023.

[1] In terms of GDP at market exchange rate.

[2] During the accommodative phase of monetary policy, *i.e.*, February 2019 to March 2022, the weighted average domestic term deposit rate (WADTDR) on fresh deposits of scheduled commercial banks and the weighted average lending rate (WALR) on fresh loans had fallen by 259 basis points and 232 basis points, respectively, in response to the repo rate cut of 250 basis points. In the recent tightening phase, *i.e.*, May 2022 to June 2023, the repo rate has increased by 250 basis points, fully offsetting the reduction in the easing phase. However, the increase in the WADTDR on fresh deposits and the WALR on fresh loans at 231 basis points and 169 basis points, respectively, trails the reduction seen in these rates during the accommodative phase.

than the 4 per cent target, the MPC decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.

Assessment of Growth and Inflation

Global Growth

The global economy continues to face daunting challenges of elevated inflation, high levels of debt, tight and volatile financial conditions, continuing geopolitical tensions, fragmentations and extreme weather conditions. Belying earlier apprehensions, a number of economies have demonstrated remarkable resilience and the grim prospects of hard landing appear to have receded. Nevertheless, global growth is likely to remain low by historical standards in the current year and next few years, despite the upward revision in the global growth forecast for 2023 by the IMF[3]. World merchandise trade volume growth is projected by the WTO to decelerate from 2.7 per cent in 2022 to 1.7 per cent in 2023. Headline inflation is easing unevenly across countries and remains above the target in major economies. While the pace of monetary tightening has been scaled down, policy rates could stay higher for longer. Financial markets, which had been buoyed by expectations of an early end to the cycle of monetary tightening, have turned volatile with sizeable two-way movements in response to recent rating event and incoming data.

Domestic Growth

These external factors are likely to impinge on the growth prospects of most major advanced and emerging economies. India is, however, expected to withstand these external headwinds far better than many other countries.

The momentum of overall economic activity in India continues to be positive. On the supply side, crop sowing has picked up with steady progress in the south-west monsoon.[4] The temporal and spatial distribution of monsoon has, however, been uneven. Industrial activity is holding ground as is evident from the latest data on index of industrial production (IIP), core industries output and purchasing managers' index (PMI) for manufacturing[5]. Buoyant services activity is reflected in healthy expansion in e-way bills, toll collections, railway freight and a sharp jump in services PMI.[6] On the other hand, commercial vehicle sales and domestic air cargo traffic contracted during Q1:2023-24.

Aggregate demand conditions continue to be buoyant. Among urban demand indicators, domestic air passenger traffic, passenger vehicle sales and households' credit are exhibiting sustained growth. In the case of rural demand, tractor and fertiliser sales improved in June while two-wheeler sales moderated. High growth in agricultural credit and improving sales volume of major fast moving consumer goods (FMCG) companies suggest incipient recovery in rural demand, which will be reinforced by improving *kharif* prospects.

Investment activity gained further steam on the back of government capital expenditure[7], rising business optimism and revival in private capex in

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[3] According to the IMF, annual average global growth rate during 2000 to 2019 was 3.8 per cent.

[4] The total area sown under *kharif* crops was 0.4 per cent higher than a year ago as on August 4, 2023. Cumulative rainfall during south-west monsoon was the same as the long period average up to August 9, 2023. The storage in major reservoirs on August 3 was at 56 per cent of the full capacity, higher than the decadal average of 50 per cent, but below 60 per cent a year ago.

[5] The index of industrial production (IIP) expanded by 5.2 per cent in May while core infrastructure output rose by 8.2 per cent in June. The purchasing managers' index (PMI) for manufacturing was 57.7 in July.

[6] PMI services rose to 62.3 in July from 58.5 in June led by robust demand and new business gains, signaling the sharpest expansion in output since June 2010.

[7] The capital expenditure by the Central government increased by 59.1 per cent (y-o-y) during Q1:2023-24. Information available for 20 states indicates that their capital expenditure jumped by 74.4 per cent (y-o-y) during Q1:2023-24 as compared with a contraction of 8.7 per cent a year ago.

certain key sectors.[8] Continued increase in import and production of capital goods further reaffirms this trend. Construction activity also remained strong in Q1 as indicated by healthy growth in cement production and steel consumption. Capacity utilisation in the manufacturing sector at 76.3 per cent (and 74.1 per cent on seasonally adjusted basis) remained above the long-term average of 73.7 per cent.[9] The total flow of resources to the commercial sector from banks and other sources taken together has increased by ₹7.5 lakh crore during the financial year 2023-24 so far (up to July 28) as compared with ₹5.7 lakh crore a year ago[10]. On the downside, merchandise exports and non-oil non-gold imports contracted further in June and the growth in services exports decelerated amidst slowing external demand.

Looking ahead, these underlying developments and the upcoming festival season are expected to provide support to private consumption and investment activity. The spillovers emanating from weak external demand and protracted geopolitical tensions, however, pose risks to the outlook. Taking all these factors into consideration, real GDP growth for 2023-24 is projected at 6.5 per cent with Q1 at 8.0 per cent; Q2 at 6.5 per cent; Q3 at 6.0 per cent; and Q4 at 5.7 per cent. Real GDP growth for Q1:2024-25 is projected at 6.6 per cent. The risks are evenly balanced.

Inflation

The moderation in headline inflation to 4.6 per cent in Q1 of 2023-24 was in line with the projections set out in the June MPC meeting. There was a pick-up in headline inflation to 4.8 per cent in June due to an upturn in food inflation. On the positive side, inflation excluding food and fuel (core inflation) has softened by more than 100 basis points from its recent peak in January 2023. The month of July has witnessed accentuation of food inflation, primarily on account of vegetables. The spike in tomato prices and further increase in prices of cereals and pulses have contributed to this. Consequently, a substantial increase in headline inflation would occur in the near-term.

Going by the past trends, vegetable prices may see a significant correction after a few months. The prospects of *kharif* crops have brightened, thanks to improvement in the progress of the monsoon. Uncertainties, however, remain on domestic food price outlook due to sudden weather events and possible *El Niño* conditions in August and beyond. Global food prices are also exhibiting a hardening bias on renewed geopolitical tensions. Crude oil prices have firmed up in recent weeks and its outlook is clouded by demand-supply uncertainties.

Assessment of the future trajectory of inflation is a continuous process. We have a choice to modify our inflation projections in every meeting of MPC, if warranted, in the interest of better guidance; or avoid frequent changes and revise them only on fewer occasions for simplicity of presentation. Given the continuing uncertainties, our latest CPI inflation projections for 2023-24, assuming a normal monsoon, is revised to 5.4 per cent, with Q2 at 6.2 per cent, Q3 at 5.7 per cent and Q4 at 5.2 per cent. CPI inflation for Q1:2024-25 is projected at 5.2 per cent. The risks are evenly balanced.

Headline inflation projection for Q2 of 2023-24 has been revised up substantially, primarily due to the price shock from vegetables. Given the likely short-term nature of these shocks, monetary policy can look through high inflation prints caused by such shocks for some time. The frequent incidences of recurring

[8] Metals, petroleum, automobile, chemicals, iron and steel, cement and food and beverages.

[9] 76.3 per cent pertains to Q4:2022-23; long term average pertains to Q1:2008-09 to Q4:2022-23 excluding Q1:2020-21.

[10] Data on flow of resources exclude the impact of the merger of a non-bank with a bank.

food price shocks, however, pose a risk to anchoring of inflation expectations, which has been underway since September 2022. The role of continued and timely supply side interventions assumes criticality in limiting the severity and duration of such shocks. In such circumstances, it is necessary to be watchful of the emerging trends and risks to price stability. We have to stand in readiness to go beyond keeping Arjuna's eye to deploying policy instruments, if necessary. I reiterate what I said in my June policy statement: bringing headline inflation within the tolerance band is not enough; we need to remain firmly focused on aligning inflation to the target of 4.0 per cent.

Liquidity and Financial Market Conditions

The level of surplus liquidity in the system has gone up in the recent months on the back of return of ₹2000 banknotes to the banking system, RBI's surplus transfer to the government, pick up in government spending and capital inflows. The overall daily absorption under the liquidity adjustment facility (LAF) was ₹1.7 lakh crore in June and ₹1.8 lakh crore in July 2023.

Despite such surplus liquidity, market response to RBI's 14-day variable rate reverse repo (VRRR) auctions was lukewarm; instead, banks preferred to place their surplus liquidity in the less remunerative standing deposit facility (SDF). Although the fine-tuning VRRR auctions of 1-4 days maturity during this period evoked better response from the market[11], this essentially reflects greater risk aversion among banks to park large funds under the main operation. In this context, it is necessary to reiterate that fine-tuning operations (overnight and up to 13 days) are undertaken to deal with special or exceptional situations and cannot become the rule.

In recent years, our stated stance on liquidity is to maintain adequate liquidity in the system to meet the productive requirements of the economy. Excessive liquidity, on the other hand, can pose risks to price stability and also to financial stability. Hence, efficient liquidity management requires continuous assessment of the level of surplus liquidity so that additional measures are taken as and when necessary to impound the element of excess liquidity. Accordingly, it has been decided that with effect from the fortnight beginning August 12, 2023, scheduled banks shall maintain an incremental cash reserve ratio (I-CRR) of 10 per cent on the increase in their net demand and time liabilities (NDTL) between May 19, 2023 and July 28, 2023. This measure is intended to absorb the surplus liquidity generated by various factors referred to earlier including the return of ₹2000 notes to the banking system. This is purely a temporary measure for managing the liquidity overhang. Even after this temporary impounding, there will be adequate liquidity in the system to meet the credit needs of the economy. The I-CRR will be reviewed on September 8, 2023 or earlier with a view to returning the impounded funds to the banking system ahead of the festival season. I must add that the existing cash reserve ratio (CRR) remains unchanged at 4.5 per cent.

Financial Stability

The Indian financial sector has been stable and resilient, as reflected in sustained growth in bank credit, low levels of non-performing assets and adequate capital and liquidity buffers.[12] Macro stress tests for credit risk reveal that scheduled commercial banks (SCBs) would be able to comply

[11] The average bid-cover ratio of five14-day VRRR auctions was 38.4 per cent and that of 11 fine-tuning VRRR auctions of 1-4 days maturity was 46.2 per cent.

[12] The capital to risk-weighted assets ratio (CRAR) and the common equity tier 1 (CET1) capital ratio of SCBs were at historical highs of 17.1 per cent and 13.9 per cent, respectively, in March 2023. SCBs' gross non-performing assets (GNPA) ratio continued downtrend and fell to a 10-year low of 3.9 per cent in March 2023, while the net non-performing assets (NNPA) ratio declined to 1.0 per cent.

with the minimum capital requirements even under severe stress scenarios. There is, however, no room for complacency because it is during tranquil and good times that vulnerabilities may creep in. Hence, buffers are best built up during these periods. A stable financial system is a prerequisite for price stability and sustained growth. This is a shared responsibility in which regulated entities like banks, NBFCs and others are important stakeholders. On its part, the Reserve Bank remains steadfast in its commitment to safeguard the financial system from the emerging and potential challenges. We expect the same from the regulated entities also.

External Sector

India's current account deficit (CAD) was contained at 2.0 per cent of GDP in 2022-23 as compared with 1.2 per cent in 2021-22. Merchandise trade deficit has narrowed in Q1 of 2023-24 with contraction in imports exceeding contraction in exports. Services exports and remittances are, however, expected to provide cushion to the current account deficit. We, therefore, expect CAD to remain eminently manageable during the current financial year also.

On the financing side, foreign portfolio investment (FPI) flows have remained buoyant in 2023-24 so far. Net FPI inflows have been US$ 20.1 billion up to August 8, 2023 which is the highest since 2014-15. In the corresponding period of the previous year, there were net outflows of US$ 12.6 billion. The inflows under external commercial borrowings also witnessed a turnaround, with net inflows of US$ 6.0 billion during April-June 2023 as against net outflows of US$ 2.9 billion a year ago. Net foreign direct investment (FDI) flows to India, on the other hand, fell to US$ 5.5 billion during April-May 2023 from US$ 10.6 billion a year ago, reflecting a global slowdown in FDI flows. Latest available data suggest that India's external debt to GDP ratio improved to 18.9 per cent at end-March 2023 from 20.0 per cent at end-March 2022.

The Indian rupee has remained stable since January 2023. Foreign exchange reserves have crossed US$ 600 billion mark. The umbrella has gathered further strength; and I am not saying this in the context of the monsoon rains![13]

Additional Measures

I shall now announce certain additional measures.

Review of Regulatory Framework for Financial Benchmark Administrators

It has been decided to revise the extant regulations issued in June 2019 and put in place a comprehensive, risk-based framework for administration of financial benchmarks. This will cover all benchmarks related to foreign exchange, interest rates, money markets and government securities. The revised directions will provide greater assurance about the accuracy and integrity of financial benchmarks.

Review of Regulatory Framework for Infrastructure Debt Fund - NBFCs (IDF-NBFCs)

At present, Infrastructure Debt Funds (IDFs) provide refinancing facilities for lenders in the infrastructure sector. The extant regulatory framework for IDFs has been revised. The key changes in the revised framework are: (i) withdrawal of the requirement to have a sponsor for the IDFs; (ii) allowing IDFs to finance toll-operate-transfer (ToT) projects as direct lenders; (iii) permitting IDFs to raise funds through ECBs; and (iv) making tri-partite agreements optional for PPP projects. These changes are expected to further augment the capacity for infrastructure financing in the country.

[13] The forex reserves are accumulated by RBI when the capital inflows are strong. Similarly, when forex outflows cause excessive volatility in the exchange rate of Indian Rupee, the RBI supplies US dollars to the market to curb volatility and to ensure that there is adequate forex liquidity. Thus, forex reserves are like an umbrella to use during rainy days (Please see: "Banking Beyond Tomorrow"; RBI Governor's speech at the Bank of Baroda's Annual Banking Conference, July 2022).

Greater Transparency in Interest Rate Reset of Equated Monthly Instalments (EMI) based Floating Interest Loans

It is proposed to put in place a transparent framework for reset of interest rates on floating interest loans. The framework will require Regulated Entities to (i) clearly communicate with borrowers for resetting the tenor and/or EMI; (ii) provide options for switching to fixed rate loans or foreclosure of loans; (iii) disclose various charges incidental to the exercise of the options; and (iv) ensure proper communication of key information to borrowers. These measures will further strengthen consumer protection.

Consolidation and Harmonisation of Instructions for Supervisory Data Submission

The Reserve Bank has, from time to time, issued several guidelines on submission of supervisory returns by supervised entities. It has been decided to consolidate and harmonise such guidelines into a single Master Direction to reduce compliance burden and to promote greater ease of doing business for supervised entities.

Conversational Payments and Off-line Capability on UPI; Enhancement in Transaction Limit of Small Value Off-line Digital Payments

With the objective of harnessing new technologies for enhancing the digital payments experience for users, it is proposed to (i) enable "Conversational Payments" on UPI, which will enable users to engage in conversation with AI-powered systems to make payments; (ii) introduce offline payments on UPI using Near Field Communication (NFC) technology through 'UPI-Lite' on-device wallet; and (iii) enhance the transaction limit for small value digital payments in off-line mode from ₹200 to ₹500 within the overall limit of ₹2000 per payment instrument. These initiatives will further deepen the reach and use of digital payments in the country.

Public Tech Platform for Frictionless Credit

The Reserve Bank, in association with the Reserve Bank Innovation Hub (RBIH), started a pilot project in September 2022 for frictionless credit delivery through end-to-end digital processes, starting with Kisan Credit Card (KCC) loans. The pilot for KCC loans is currently operational in select districts of Madhya Pradesh, Tamil Nadu, Karnataka, UP and Maharashtra. Recently, dairy loans have been included in the pilot project in select districts of Gujarat. Based on the learnings from the pilots and to expand the scope of end-to-end digital lending processes, a Public Tech Platform for Frictionless Credit delivery is being developed by the RBIH. The Platform is intended to be rolled out as a pilot project in a calibrated manner. It will have an open architecture and open Application Programming Interface (API) and Standards, to which all financial sector players can connect seamlessly. This initiative will accelerate the penetration of credit to hitherto underserved regions and further deepen financial inclusion.

Conclusion

We have made good progress in sustaining India's growth momentum. While inflation has moderated, the job is still not done. Inflationary risks persist amidst volatile international food and energy prices, lingering geopolitical tensions and weather-related uncertainties. In charting the course of monetary policy, we continuously assess the impact of our past actions, the evolving inflation dynamics and the implications of incoming data for the economic outlook. I reiterate our commitment to align CPI inflation to the 4 per cent target on a durable basis. We do look through idiosyncratic shocks, but if such idiosyncrasies show signs of persistence, we have to act. As we prepare to celebrate the Independence Day, the air is filled with hope and promise. Let me end by recalling the prophetic words of Mahatma Gandhi *"…I have no doubt that our country would rise to the greatest height among the nations of the world."*[14]

Thank you. Namaskar.

[14] *The Collected Works of Mahatma Gandhi*, Volume 95: April 30-July 6, 1947.